

Pay for Performance in a Management Control Context

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Abstract

Otley et al. (1995) allege management accounting has become narrow in its focus and believe research is needed in broader areas. The areas of performance measurement and control have been suggested as a topic which warrants further management accounting research (Otley et al., 1995).

Organisations are facing a very different environment to that of 20 years ago. Management accounting has failed to keep pace with these changes when designing management control systems (Otley, et al., 1995). Furthermore:

“Research from the UK and USA has shown that [performance measurement and control] is an area financial directors are the least satisfied with” (Haq, 1995, p. 20).

The culture of a country must be considered when developing a compensation system. However, there has been a dearth of research on the topic of pay for performance in a New Zealand context and the decentralisation of the remuneration functions to individual business units.

Consequently a case study was conducted at Business Unit A of the Christchurch City Council. This examined the process followed by Business Unit A to develop and implement a pay for performance system for their Unit.

Prior to this research, these aspects of design and implementation have not been addressed in a New Zealand context. Despite the human bias possible when conducting case studies and other limitations, the body of knowledge surrounding pay for performance has been expanded and areas for future research recommended.

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Chapter 1

Introduction

“The important thing is not to stop questioning....One cannot help but be in awe when he contemplates the mysteries of eternity, of life, of the marvelous structure of reality. It is enough if one tries merely to comprehend a little of this mystery every day”

Einstein (1879-1953)

Otley et al. (1995) allege management accounting has become narrow in its focus and believe research is needed in broader areas. The areas of performance measurement and control have been suggested as topics which warrant further management accounting research (Otley et al., 1995).

Organisations are facing a very different environment to that of 20 years ago. Management accounting has failed to keep pace with these changes when designing management control systems (Otley, et al., 1995). Furthermore:

“Resesarch from the UK and USA has shown that [performance measurement and control] is an area financial directors are the least satisfied with” (Haq, 1995, p. 20).

As wages are a large cost to an organisation, it is particularly important that this area is investigated. Management accountants have the skills to design compensation systems and need to take a more active role than they have in the past (Tang et al., 1987).

Drury and Tayles (1995) note that “information about management accounting practices is ... almost all ... anecdotal” (p. 267). Much of the current literature in the area of pay for performance originates from consultants working in the field of human resources, and managers of companies who have been examining and changing their compensation systems.

Employees, of a large company, were surveyed to assess their reaction to the

implementation of a performance based pay plan (Lowery et al., 1996). It was found the overall reaction to the plan was very positive. However, there were some concerns with regard to the implementation aspect of the pay for performance plan.

There has been a dearth of case study research on the topic of pay for performance, particularly in a New Zealand context. Furthermore, the implications of decentralising remuneration issues to individual business units have not been addressed. Hence, the research objective of this thesis is:

To examine the design and implementation of a pay for performance system in a New Zealand public sector organisation.

Consequently a case study has been conducted at Business Unit A of the Christchurch City Council. This examined the process followed by Business Unit A to develop and attempt to implement a pay for performance system.

This thesis commences with a review of the literature surrounding pay for performance. Chapter 2 provides context for this research and examines history, theories of motivation, and the advantages and disadvantages of pay for performance systems. Chapter 3 offers suggestions to ensure the effective design and implementation of a system. The case study method was utilised in this research and is discussed in Chapter 4. The findings illustrate the complex nature of design and implementation of a pay for performance system and are presented in Chapter 5. These findings must be read in conjunction with the limitations of this research. Limitations and suggestions for further research are presented in Chapter 6 and are followed by concluding observations in Chapter 7.

Chapter 2

Pay for Performance and the Management Control Process

1. INTRODUCTION

“An important aspect of managerial control in organisations is motivating managers and employees to pursue the organisation’s interests as they undertake their daily tasks” (Institute of Chartered Accountants of New Zealand, 1997, p. 5).

Otley et al. (1995) believe management accounting has become narrow in its focus and allege research is needed in broader areas. The areas of performance measurement and control have been suggested as topics which warrant further management accounting research (Otley et al., 1995). Furthermore, management accountants have the skills to design compensation systems and need to take a more active role than they have in the past (Tang et al., 1987).

Pay for performance can be used as a management control tool to achieve goal congruence and motivate an organisation’s employees. This chapter defines pay for performance and reviews its historical background. This is followed by a discussion of the theory that supports pay for performance. Finally, the advantages and disadvantages of these systems are examined.

2. DEFINITION OF PAY FOR PERFORMANCE

A compensation package will typically include a combination of base salary, short and long-term incentives¹, benefits, and perquisites (Lew and Kolodzieff, 1993). Benefits include items such as medical, life insurance and pension plans, and perquisites include use of a company car, club memberships, and cellular telephones

(Lew and Kolodziej, 1993).

Incentives are an important part of a well trained, motivated workforce. This is imperative to success in today's highly competitive business environment (Wakefield, 1994). Incentive pay may be dependent on the performance of an individual, a team or division, the organisation, or a combination of them all. Consequently this type of payment is known as pay for performance. Pay for performance is also known as performance-based pay (Berger and Moyer, 1991), performance-related pay (Fowler, 1988), and variable pay (Weiss, 1990)².

In order to understand pay for performance and the role it plays in an organisation, one must observe the organisation as a whole. An integral part of any organisation is a management control system. A management control system is "a tool to aid management in moving an organization towards its strategic objectives" (Anthony and Govindarajan, 1995, p. 10). Its central role is to promote goal congruence between employee and organisational goals (Anthony and Govindarajan, 1995). A number of interrelated components make up a management control system (Rotch, 1993; Teall, 1992). The key components are illustrated in Figure 2-1 (page 6).

One management control system is a performance management system. Performance management is defined as:

"the mission and strategy that align the organization's reward system and the productive capacity of its employees with the organization's vision and strategic business plan. Under this definition, performance management also:

- reinforces the organization's value system;
- provides for clear understanding of expectations;
- rewards only those who deserve rewards;
- offers opportunities for growth and development (not limited to promotions);
- recognizes the individual needs and aspirations of employees;
- has congruency with staffing plans to provide the correct number of employees with the right skill/experience mix;

¹ Both financial and non-financial.

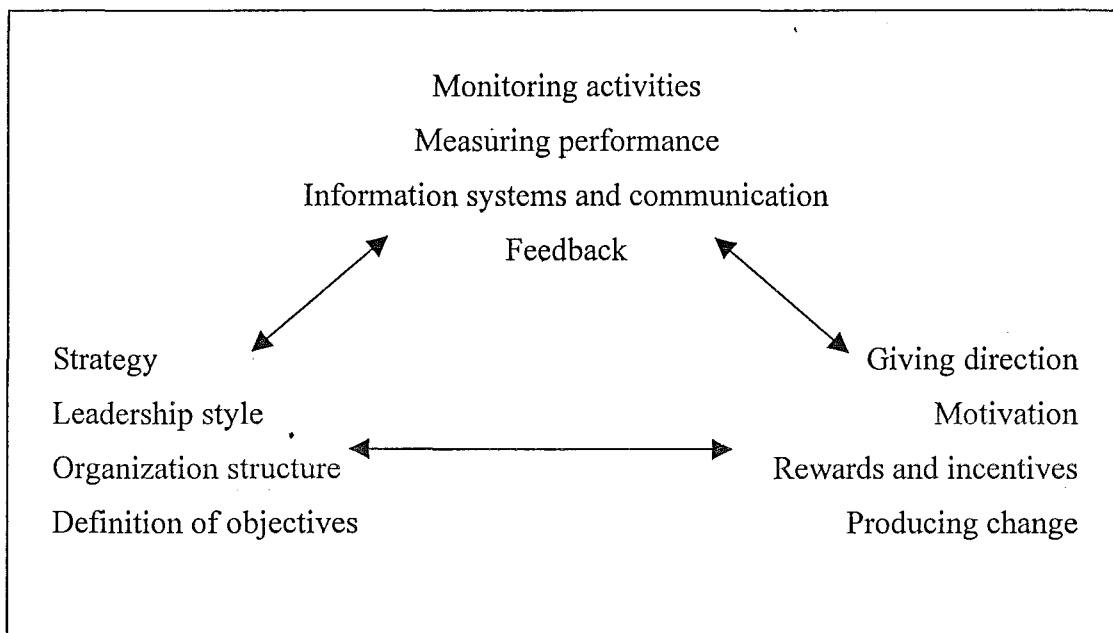
²To aid consistency, the term pay for performance will be substituted for the other terms throughout this research. Variable pay may also refer to a type of pay for performance where a percentage of base pay is at risk and will be earned only if targets are met (Giblin and Kelley, 1994).

- has enough flexibility to fit various structures and organization alignments while accepting changes in the number of managerial levels and the proper degree of decentralization; and
- provides recognition for achievement of the organization's objectives" (Stewart 1993, pp. 20-21).

This is illustrated in Figure 2-2 (page 6).

Figure 2-1 - Key Components of a Management Control System

(Rotch, 1993, p. 192)



Within the framework of a performance management system, an organisation may decide to include some form of pay for performance. This is only part of a performance management system, and most often involves linking all or part of an employees remuneration to the achievement of predetermined goals, as assessed through performance appraisal (Brough, 1994).

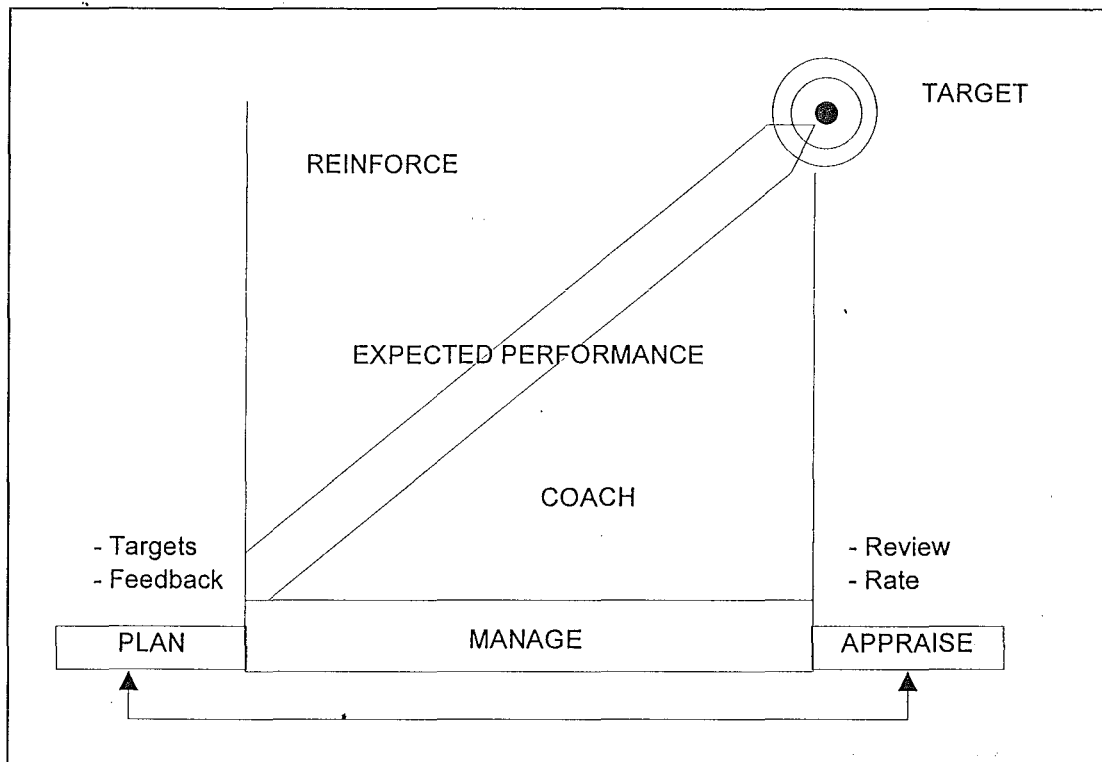
Pay for performance is defined as:

“a method of setting very specific performance objectives for individual employees in a company and tying a substantial portion of an employee's compensation to the successful achievement of those objectives” (Geske, 1989, p. 27).

Kinnie and Lowe (1990) believe a pay for performance scheme:

“attempt[s] to relate some propositions of pay not just to individual output but also to other indicators of performance such as quality, flexibility, contribution to teamworking and ability to hit targets” (p. 45).

Figure 2-2 - Performance Managing
(Guinn, 1987, p. 41).



Silburt (1987) maintains pay for performance is “a form of compensation that gives employees attractive incentives to work harder and more effectively” (p. 72). Whereas, Schuler and Youngblood (1986) simply state that pay for performance systems “relate pay to performance” (p. 327).

The term pay for performance encompasses a multitude of different systems, that are often difficult to distinguish between (Applebaum and Shapiro, 1991). For this reason they are collectively referred to as performance pay systems, or pay for performance (Sheffield Consulting Group, 1997). These schemes may be based on team or individual performance, or many include elements of both.³

INDIVIDUAL SYSTEMS

Individual pay for performance systems are appropriate when a “job is well defined and the performance characteristics are both well delineated and assessable”

³ These systems are not always considered to be ‘true’ pay for performance systems. Often this is dependant on the structure and design of a system (McGinty and Hanke, 1989; Sahl, 1994a; Tang et al., 1987).

(Applebaum and Shapiro, 1991, p. 31). If individual incentives are used when teamwork is important to the business' success, this will have a detrimental effect on organisational performance (Gandossy and Scheffel, 1995). Examples of individual pay for performance systems include:

- i) **Pay for knowledge:** Pay for knowledge rewards an employee for the ability to perform a task or skill (Krajci, 1990). These types of systems are particularly suited to technical professions (Franklin, 1988), and in those positions where cross training is important (Morris, 1996).
- ii) **Competency based pay:** Competency based pay measures "sets of employee skills and their related outcomes under the banner of a competency" (Laymon, 1996, p. 35).
- iii) **Maturity curve compensation:** When an organisation utilises a maturity curve compensation system "pay varies with discipline, degree, and years of experience" (Mahoney, 1989, p. 340).
- iv) **Merit pay:** Under a merit pay system increases in base pay are determined by an individual's performance (Sullivan, 1988).
- v) **Variable pay:** With this system a percentage of base pay is at risk and will be earned only if targets are met (Giblin and Kelley, 1994).

GROUP SYSTEMS

Group incentive systems are:

"appropriate under conditions where direct supervision is not readily feasible, exact measurement of individual work performance is difficult, and where teamwork and co-operation are essential to success" (Applebaum and Shapiro, 1991, p. 34).

Further, when non-management employees have a measurable effect on an organisation's success group incentives will be beneficial (Chingos and Lind, 1990).

Examples of group pay for performance systems include:

- i) **Team incentives:** A group of employees receive rewards based on the achievement of predetermined team goals (Gross and Bacher, 1989).

- ii) **Stock option plans:** An employee is given the right to purchase company shares for a set price at a future date (MacDonald, 1988).
- iii) **Profit-sharing:** Employees receive a bonus based on the organisation's profit (Anonymous, 1995).
- iv) **Gain-sharing plans:** A formula is used to calculate employees share of financial gains due to improved performance (Harris, 1996; Parnell, 1991). The plans are self funding (Flannery et al., 1996), with goals that may include improving productivity, quality and customer service (Anonymous, 1996a; Perry, 1988). The difference between gain-sharing and profit-sharing is the former generally has goals related to productivity rather than profit (Anonymous, 1996a).

INDIVIDUAL OR TEAM SYSTEMS

There are some pay for performance plans that may be either individual or team based, depending on the objective of the plan. Examples include:

- i) **Lump sum payments or bonuses:** Employees are given a lump sum payment in lieu of an increase in salary (Harris, 1996). This does not become part of base salary (Perry, 1988).
- ii) **Incentive pay plans:** An incentive payment is "based on achievement of specific individual, divisional, or company-wide goals" (Rich and Florin-Thuma, 1990, p. 17).

Organisations that have adopted a pay for performance system may believe they are paying their employees based on performance, however, if there is little differentiation between employees in the same department, they are paying "endurance-based compensation"⁴ (McSparran, 1993, p. 119; McGinty and Hanke, 1989). Employees are therefore being paid for "attendance instead of performance" (Muczyk, 1988, p. 233). When there is little differentiation between employees, this practice creates an environment where employees feel they are entitled to increases in pay regardless of performance (Case, 1996; McSparran, 1993; Stewart et al., 1993).

⁴ Also known as skill based pay (Krajci, 1990).

⁵ Where employees are paid according to the length of employment with the organisation.

In such an environment employees are not convinced of the link between their pay and their performance (Lowery et al., 1996; McGinty and Hanke, 1989; Sullivan, 1988; Wilkerson, 1995). This is often exacerbated by organisations keeping compensation information secret. The employee is then “asked to accept as an article of faith that pay and performance are related” (Lawler, 1981, p. 50). As Applebaum and Shapiro (1991) note “the secrecy of pay is related to perceived inequity” (p. 33).

Pay for performance must be an integral part of the entire management process, and:

“must be linked to the economic and operational realities of the enterprise. Top pay and benefits are not employee rights or entitlements. They are contingencies - contingent, ultimately, upon the enterprise’s long-term economic success” (p. 42).

The traditional method of paying employees must be replaced with a new effective approach to remuneration (Giblin and Kelley, 1994). However, pay for performance is not a new phenomenon. It has a lengthy history that dates back to circa 18th century.

3. HISTORY OF PAY FOR PERFORMANCE

“Although the use of incentives to stimulate performance occurs throughout history, for the greater part of recorded history the use of incentives was intuitive, reflecting individual responses to the immediate requirements of specific situations, rather than a natural outcome of generally held theoretical propositions” (Peach and Wren, 1992, p. 22).

The Code of Hammurabi⁶ (circa 18th century B.C.) provides the earliest reference to incentives (Peach and Wren, 1992). It refers to travelling merchants who were agents for people in the cities. The travelling merchants made no profit until they doubled their employers investment. Simplistic incentives schemes such as this continued throughout the Middle Ages⁷, usually in the form of a piece rate system⁸.

⁶ Hammurabi was the sixth King of Babylon. His code was a collection of Babylonian laws.

⁷ The Middle Ages generally refers to the period commencing with the fall of the Western Roman Empire (in the 5th century), and ending in the 16th century with the Renaissance (The Macmillan Encyclopaedia, 1986).

⁸ Employees paid on a piece rate system are paid per unit of output (The Macmillan Encyclopedia, 1986).

During the Industrial Revolution⁹, incentive schemes became much more complex. Efforts to improve productivity were resisted by employees as the schemes were characterised by subjective performance standards and rate cutting¹⁰.

By the end of this era, economists had developed a theory of wages¹¹ and Frederick Taylor and other engineers were responding to the disadvantages of subjective performance standards. Taylor (1911)¹² developed standards for work that were more objective, based partially on time study, and had an immense influence on modern incentive plans. As Peach and Wren (1992) note, “[t]he era of scientific management spawned a litany of incentive plans, many attributable to disciples of Taylor” (Peach and Wren, 1992, p. 16).

From the 1920s, incentives were being challenged by social scientists who believed factors such as human relations and employee motives should be taken into consideration when attempting to motivate employees. The combination of economic and social theory led behavioral scientists to develop motivation theories such as expectancy and equity theory¹³ (Peach and Wren, 1992).

For much of the 1970s, compensation design focused on entitlements. It was not until the 1980s that organisations began to view compensation systems as an important part of the management process (Young, 1990). Organisations were starting to recognise the importance of the design of compensation systems, become more aware of the role incentives can play, and apply these elements to more sectors within their organisation (Young, 1990).

Pay for performance was initially applied to executives and top management. This is gradually being extended to a larger proportion of an organisation’s employees, and

⁹ The Industrial Revolution refers to the transformation of countries from agricultural to industrial economies. This process commenced in approximately 1750 (The Macmillan Encyclopaedia, 1986).

¹⁰ Rate cutting is when the rate paid per unit is reduced when productivity increases (Peach and Wren, 1992).

¹¹ The Economic man [sic] assumption asserts that “monetary incentives brought out the best in people and that they would work harder to get more” (Peach and Wren, 1992, p. 10). The theory of marginal productivity states “an employer will hire until the wages paid to the last worker hired equals the value of production contributed by that worker” (Peach and Wren, 1992, p. 11).

¹² Cited in Peach and Wren (1992).

¹³ These theories will be defined in a later section.

in some organisations to the entire workforce (Banker et al., 1996; Geske, 1989; Proctor et al., 1993; Ross, 1988).

Middle managers in particular have been the subject of discussion. Ross (1988) contends middle managers should be included in pay for performance systems as they:

“have a very significant effect on company performance because they control many day-to-day operations and their cumulative decisions greatly affect profits. They implement strategic business objectives” (p. 34).

Weiss (1990) believes few middle managers are included in such plans because of the difficulty in coming up with objective measures of performance. Whereas, Chingos and Lind (1990) state middle managers are routinely included in pay for performance plans.

“Research has supported the fact that it is increasingly important to motivate indirect/support people to improve their productivity. It is vital that management visibly recognise that such people are essential and significantly contribute to the organisation’s profitability (Applebaum and Shapiro, 1991, p. 38).

Applebaum and Shapiro (1991) believe all employees should have the opportunity to benefit from pay for performance. However, when Italian motor vehicle company Fiat implemented their pay for performance system, they decided not to extend it lower into the management hierarchy. They believed the benefits of extending the system to lower levels of management would have been negated by the dramatic increase in administration and incentive costs (Merchant and Riccaboni, 1990).

Milkovich (1988) believes:

“certain employee groups may be more (or less) critical to the success of the organization than others, it follows that their reward systems become an important part of implementing the organizations business strategy” (p. 266).

It is important to target those that influence an organisation’s performance, or the scheme may become too expensive to sustain (Anonymous, 1988). However, there are a number of reasons an organisation may adopt pay for performance and push the schemes into the lower levels of the organisation (Fowler, 1988). These include:

- Organisations which are trying to achieve a change of culture see performance pay as one of the means of changing employee attitudes. It makes little sense, therefore, to restrict these pay schemes to managerial staff - all staff need to be influenced by a new emphasis on the value of high individual and team performance¹⁴.
- A weakening of trade union power in some organisations has made it possible to extend performance pay into sectors of the workforce where in previous years such developments might well have resulted in industrial action. Trade unions, while still opposed in principle to individual merit appraisal, are slowly adopting a more pragmatic approach.
- In some organisations, particularly in the public sector, performance pay is seen as a means of achieving more attractive and competitive salary levels. Most public bodies are experiencing severe recruitment and retention problems across the whole white-collar professional sector. If performance pay is used to make salaries more attractive, it has to be applied across all these jobs and not be restricted to managerial staff (Fowler, 1988, pp. 32-33).

Smith (1992) believes that organisations should not necessarily utilise centralised remuneration systems. Rather, individual units should be responsible for their own remuneration issues. This approach to remuneration is compatible with the decentralised structures where managers have considerable autonomy (Smith, 1992). It will work effectively when there are clear lines of authority within business units. Central human resources staff will provide guidance to the managers making the decisions rather than issuing directives on remuneration issues (Smith, 1992). Devolution of authority of the remuneration functions to individual business units, has not been widely researched. The literature fails to report whether organisations that take this approach to remuneration design, face distinct advantages and disadvantages. Further research in this area is needed.

Pay for performance was initially more prevalent in the private sector. However, public sector organisations are increasingly adopting variations of pay for performance (Fowler, 1988). The movement of pay for performance into the public sector could not have occurred without a radical change in the mindset of the affected organisations (Fowler, 1988). Previously, public sector remuneration philosophy had been (and still is in some situations) if employees are rewarded equally, then they are

¹⁴ The influence of culture on performance based pay is discussed in Chapter 3.

rewarded equitably (Murray and Kuffel, 1978). As Fowler (1988) notes “[t]o identify some employees as better than others implied a variability of service which was inconsistent with the principle of impersonal uniformity” (p. 32). It is important that pay for performance systems are not used as a substitute for management (Gandossy and Scheffel, 1995), for in essence this will merely delay the inevitable need for change in these areas (Fuller-Love and Scapens, 1997).

In the mid 1980s, New Zealand commenced a period of radical public sector reform. The New Zealand model of public management adopted a number of policies in the mid 1990s concerning performance. The following policies are an example of those related to performance and illustrate the change in mindset the public sector needed to introduce pay for performance:

- A strong emphasis on the use of incentives to enhance performance, at both the institutional and the individual level (e.g. short-term employment contracts, performance-based remuneration systems, promotion systems, etc.).
- The development of integrated and relatively sophisticated strategic planning and performance management systems throughout the public sector. Key elements include the specification by ministers of strategic result areas and key result areas and the integration of these into [Chief Executive’s] performance agreements and departmental purchase agreements (Boston et al., 1996, p. 5).

Fletcher Challenge Limited’s human resource manager, Rob Keen¹⁵, believes tying executives pay to performance is the way of the future. The introduction (or resurrection) of pay for performance systems in New Zealand is a reflection of two factors. First, New Zealand companies are now competing in the global market for top quality management (MacAlister, 1994; Muczyk, 1988); and second they are being influenced by management practices of the foreign companies which are buying into them (MacAlister, 1994). Greg Milano, Vice President of Stern Stewart¹⁶, believes incentive schemes in New Zealand are a “natural evolution of New Zealand’s business world since the deregulation and privatisation of the 1980s” (MacAlister, 1994, p. 43). The use of pay for performance systems is widespread in

¹⁵ Cited in MacAlister (1994), not referenced.

¹⁶ Cited in MacAlister (1994), not referenced.

both the public and private sectors of New Zealand. 67% of organisations have incentive systems (Watson Wyatt, 1996¹⁷). They feature strongly in Telecommunications/Electronics/IT (91%) and Pharmaceutical/Chemical sectors (95%). Pay for performance systems are also featured more in larger organisations. 35% of organisations with less than 50 employees, and 100% of organisations with greater than 3000 employees, have a pay for performance system. The popularity of these systems provides indirect support for the two main motivational theories that underly pay for performance.

4. THEORIES OF MOTIVATION

Equity and expectancy theories are the foundations upon which the concept of pay for performance is built (McGinty and Hanke, 1989; Sullivan, 1988). Equity theory holds that employees wish to be equitably treated by their employers. When their compensation is not perceived to be comparable to the effort expended, action is taken to restore equity. Thus employees may increase or decrease their effort (or performance) to match their compensation (Sullivan, 1988).

Expectancy theory posits an employee is motivated to perform a task (if they believe they are capable), when offered a reward that is commensurate with the effort expended and the reward is perceived as valuable (McGinty and Hanke, 1989; Smith et al., 1987). Therefore, if an organisation does not pay employees for their performance, equity and expectancy theory states an employee's performance will not be maximised (Lowery et al., 1996).

These motivational theories dominate the literature, however they are not unanimously supported. Kohn (1993) believes "the failure of any given incentive program is due less to a glitch in that program than to the inadequacy of the psychological assumptions that ground all such plans" (p. 54). Kohn (1993) adds intrinsic motivation¹⁸ is the factor on which organisations should concentrate in order to improve performance. However, Banker et al. (1996) note:

¹⁷ Cited in Cotton (1997).

¹⁸ Where one is motivated by the challenge and enjoyment of a position (Stewart et al., 1993).

“it would be naive to assert that incentives always improve performance....in performing a task that subjects find intrinsically interesting, introduction of monetary incentives decreases subsequent interest and performance because incentives are experienced as controlling and they frequently convey a sense of incompetence” (p. 203).

This view is supported by Awasthi and Pratt (1990)¹⁹, who report, “provision of monetary incentives does not result in improved performance for subjects with low intuitive and perceptual abilities to perform a complex task” (Banker et al., 1996, p. 203). However, extrinsic incentives are not necessarily perceived as controlling (Stewart et al., 1993). While intrinsic rewards are motivating, they do not always exist, and can not always be created (Stewart et al., 1993). Further, if employees are not rewarded for exemplary performance “mediocrity will become widespread unless the work is intrinsically satisfying” (Murray and Kuffel, 1978, p. 172).

Expectancy and equity theories dominate the motivational literature. The theory that intrinsic rewards are stronger motivators than extrinsic rewards is not widely accepted (Applebaum and Shapiro, 1991). The motivational benefits of pay for performance plans are further reflected in the many advantages of introducing these systems.

5. ADVANTAGES OF PAY FOR PERFORMANCE

Pay for performance can be an effective management tool (Berger and Moyer, 1991; Bice, 1990). It can be used to influence the organisation, its employees and its customers. It has been heralded as the “most direct technique available to capitalize on the value for money” (Parnell, 1991, p. 8). A pay for performance system can do this by focusing employees on what is important to the organisation, increasing the organisation’s flexibility, improving organisational performance, and aiding in the management of employees.

¹⁹ Cited in Banker et al. (1996).

5.1.Flexibility

An organisation with a pay for performance system will have the increased flexibility that today's environment demands (Gandossy and Scheffel 1995; Turner, 1996). As Rich and Florin-Thuma (1990) note:

“Organizations are understandably reluctant to continue increasing fixed compensation in this new business environment. As an alternative, companies are turning to variable pay programs, which provide employees with financial growth without adding to fixed labor costs” (p. 16).

Instead of the traditional fixed compensation and its accompanying annual increase, an organisation's compensation is able to more closely follow organisational performance (Turner, 1996), individual performance (Anonymous, 1996b; Turner, 1996) and the external market (Anonymous, 1996b). With the advent of broad banding²⁰ an increase in pay can be given without the traditional promotion (Kerr, 1996). Pay for performance systems also reduce internal and external influences such as the 'going rate' and union involvement in pay negotiations (Proctor et al., 1993).

An effective pay for performance system enables an organisation to change direction rapidly (Geske, 1989). Geske (1989) further notes,

“[a] prime way to gain flexibility in successfully dealing with this new world is through development of an effective compensation program, one which leads management and the company as a whole in the direction of strategic goals” (p. 27).

5.2.Focus on Strategic Objectives

A successful pay for performance system will focus employees on the strategic objectives of an organisation, providing the employees performance objectives are aligned with the company's strategic objectives (Geske, 1989; Laabs, 1996). It brings the strategic objectives of an organisation to the attention of those who have the ability to influence its success (Geske, 1989; Laabs, 1996; Pederson and Lidgerding, 1995). A pay for performance system is “a tool in the implementation of

²⁰ Broad salary bands have been introduced in response to the flatter management hierarchies now prevalent in most businesses. This means a manager may stay in one broad salary band, ranging from, for instance, \$50,000 to \$100,000, for the duration of their career (Labich, 1992).

the [organisation's] business strategies" (Ross, 1988, p. 35). If well designed it can have a strong impact on organisational performance²¹.

5.3.Organisational Performance

"A control system, with management incentives, that is designed to match the characteristics of the global corporation should be a key element in achieving the superior competitive position possible from using a global strategy" (Dyment, 1987, p. 26).

Many companies believe their pay for performance systems increase performance, however they do not monitor results to find if this is true (O'Connor, 1994). Hay Consultants²² has found a positive correlation between an organisation's financial performance and the incidence of pay for performance (Bice, 1990). Improvements in productivity and profitability are a bi-product of the cultural change that a pay for performance system engenders (Ross, 1988)²³. Further, such a system can help the company move towards an "achievement-oriented" environment (Ross, 1988, p. 35). Additional evidence has been gained from KPMG Peat Marwick (1993)²⁴ who found "a financial company's ability to achieve high performance may be directly related to its emphasis on performance-based compensation and long-term incentives" (Anonymous, 1994, p. 6). However, while a pay for performance system may not immediately reduce costs or improve profits, the intention is to have a beneficial long term effect on the organisation's success (Kinnie and Lowe, 1990).

Improvements in productivity and performance are more likely under a plan that has been well designed, and has included ample training and employee involvement (Stewart et al., 1993). Along with improved financial performance and productivity, a pay for performance system can also have the effect of: improving business awareness (Kinnie and Lowe, 1990), increasing customer satisfaction (Rigg, 1992), improving quality (Anonymous, 1995; Berger and Moyer, 1991), and increasing cost

²¹ Design issues are addressed in Chapter 3.

²² Cited in Bice (1990), not referenced.

²³ Culture and pay for performance will be covered in Chapter 3.

²⁴ Cited in Anonymous (1994), incomplete reference.

efficiency (Berger and Moyer, 1991; Gross and Bacher, 1993; Rigg, 1992; Ross, 1988).

A pay for performance system also has beneficial effects on an organisation's communication systems (Kinnie and Lowe, 1990; Zemke, 1985). Inadequacies are highlighted quickly, as pay for performance is heavily reliant on efficient and effective communication at all levels of the organisation (Kinnie and Lowe, 1990). Organisations therefore tend to adopt "more open and accountable" management practices (Anonymous, 1996b, p. S6). This has beneficial effects on the management of employees.

5.4. Management of Employees

Organisations with pay for performance systems attract and retain talented employees (Banker et al., 1996; Geske, 1989; McGinty and Hanke, 1989; Ross, 1988). Potential employees who are comfortable with risk are more likely to be attracted to organisations with pay for performance systems (Lederer and Weinberg, 1996). Conversely, existing employees who are not performing are induced to lift their performance or leave the organisation (Banker et al., 1996; Postrel, 1993).

A good pay for performance system enables an organisation to identify which of their employees are performing and rewards them appropriately (Lederer and Weinberg, 1996; Ross, 1988). Similarly, underperformers can be identified and reduced (Postrel, 1993; Ross, 1988; Sink and Sahl, 1995). This has the effect of improving the quality of the employee mix (Parnell, 1991), reducing voluntary turnover (Lowery et al., 1995; Parnell, 1991), and decreasing absenteeism (Lowery et al., 1995; Parnell, 1991).

Further, evidence shows employees contribute more ideas to improve work practices when pay for performance systems are introduced (Kinnie and Lowe, 1990). Training requirements are more easily identified when a pay for performance system is implemented (Kinnie and Lowe, 1990; Zemke, 1985), as problem areas are

identified at each appraisal, and possibly earlier depending on the performance management system²⁵.

Pay for performance also prompts favourable behavioural consequences. Employees recognise employers are aware of their efforts and their performance will be rewarded appropriately (Anonymous, 1995). A well-designed pay for performance system means employees will understand what is expected of them. This engenders improved commitment from employees (Kinnie and Lowe, 1990), increased job satisfaction (Kinnie and Lowe, 1990; Lowery et al., 1995; Parnell, 1991), and increased pay satisfaction (Lowery et al., 1995).

6. DISADVANTAGES OF PAY FOR PERFORMANCE

It is important that:

“all of the implications of the program, both positive *and negative* are clearly understood by the major decision-makers of the organization. (No one should have to say, “I never thought it would turn out like this,”)” (Young, 1990, p. 349 [emphasis added]).

The contention, that pay for performance systems improve the ability of an organisation to adapt to a complex and ever changing environment, has been challenged. It has been suggested that pay for performance is outdated (Carnell, 1993) and has failed to keep pace with the complex nature of the global market (Wilkerson, 1995). Furthermore, having salary and performance evaluation based on past performance is “inconsistent with the reengineered environment of a customer-focussed organization” (Wilkerson, 1995, p. 40). Major criticisms stem from problems with the performance management process, union reaction, and adverse effects on teamwork.

6.1. Performance Management

Most pay for performance systems will include the setting of goals, how to measure progress towards the goals, and appraisal of actual performance. Each of these steps in a performance management system presents their own particular problems.

²⁵ Training is addressed in a later section.

6.1.1. Goals

“The setting of precise and meaningful objectives is crucial to [performance related pay] schemes and many of the criticisms of them stem from a failure in that process” (Brough, 1994, p. 24).

Establishing effective objectives that encompass the main aspects of each employee's position is difficult (Brough, 1994). It is therefore not surprising that there is often some question as to the quality of goals (Lowery et al., 1996). Quality of goals is compromised when they are vague or unrealistic (Brough, 1994), or when individual objectives are utilised when group ones would be more appropriate (Meehan, 1992). Another factor which reduces the effectiveness of pay for performance is when goals are “set autocratically and measured subjectively” (Rondeau, 1992, p. 13).

The quantity of the goals is also important. There are often too many objectives and this has the result of obfuscating those which are particularly important to the organisation (Meehan, 1992). If goals are ineffective, this will have a flow on effect that will affect performance measurement and the subsequent performance appraisal.

6.1.2. Performance Measurement

Development of performance criteria that explicitly identify the behaviour that will be rewarded is very difficult (Deming, 1986; Lowery et al., 1996; Parnell, 1991). Consequently performance measures are often subjective (Balkin, 1989; O'Connor, 1994), unclear (O'Connor, 1994), and in some cases the wrong performance measures are used (Minken, 1987). This means that an organisation is unable to draw accurate distinctions between an employee's performance and therefore cannot justify the differences in pay (Applebaum and Shapiro, 1991). Part of this difficulty stems from organisations having one system for measuring and rewarding performance of a group of varied employees, who play vastly different roles within an organisation (Cumming, 1988).

There has been substantial debate as to the most appropriate means of gauging performance (Young, 1990). Public Service Association researcher, Bruce Fleury²⁶

²⁶ Cited in O'Connor (1994), not referenced.

believes “effort is not measurable. Aspects of output of effort are measurable, but the measures are crude” (O’Connor, 1994, p. 26).

Performance management can pose a particular problem in the public sector. As Brough (1994) states:

“since objectives must ... be measurable [to be useful], it leads to an overemphasis on the measurable aspects of the job. This is especially a problem in the public sector, where it may result in a deterioration in overall service” (p. 24).

Deming (1986) further notes the only verifiable measure is short term. Difficulties in measuring the performance of an employee often contributes to the criticisms of performance appraisals.

6.1.3. Performance Appraisal

“It is unlikely that any managerial problem has so successfully resisted solution than arriving at an acceptable, useful and valid method for appraising performance” (Henderson, 1981, p. 8)²⁷.

Pay for performance is contingent upon employees believing there is a link between their performance and their rewards. In order to establish this connection, an organisation must have a reliable performance appraisal (Muczyk, 1988). However, a major problem with pay for performance systems are the performance appraisals (Sullivan, 1988). “At its worst it is about making retrospective judgements about such subjective aspects of performance as personality and attitude” (Rix, 1990, p. 51). Performance appraisals encourage the setting of safe goals and perpetuate the organisation’s acceptance of mediocre employee performance (Crow, 1996). Further, “evaluation of performance nourishes fear” (Deming, 1986, p. 108). This is particularly so for those on the ground level of an organisation. As Brough (1994) notes:

“Most people working on the shopfloor have probably never come out of any formal test they have taken very well – they thus feel they have everything to fear and nothing to gain – this is at the heart of their disquiet about the whole system and why, in principle, they infinitely prefer a collective system for security” (p. 21).

²⁷ Cited in Gomez-Mejia et al. (1985).

In addition, employees are less likely to voice questions for fear their supervisor will doubt their competence (Deming, 1986).

Performance appraisals are fraught with behavioural difficulties. As many as 80% of employees believe their performance would rate above average or higher (Mandt, 1984). This translates to a large proportion of the workforce who “to protect their self-esteem...will automatically accuse the company, their bosses, and the system of bias” (Mandt, 1984, p. 18). Managers and supervisors have difficulty with the performance appraisal process. They are uncomfortable providing feedback on employee’s progress (Zemke, 1985). This is evident in the many rating errors that affect performance appraisal.

6.1.4. Rating errors

“Managers often create a negative perception of the connection between pay and performance” (Lawler, 1981, p. 51).

When managers are rating employees, objectivity and consistency do not exist and bias on the part of the evaluator is inevitable (Wilkerson, 1995). This results in rating errors when appraising an employee’s performance. Rating errors occur when, for various reasons, managers rate employees based on factors other than performance. The central tendency rating error may be the most serious (Lawler, 1981). This is where supervisors avoid rating employees in any of the extreme categories. Ratings are therefore clustered around the midrange (Lawler 1981; Tudor et al., 1996). It is easier for managers to rate in a safe range, particularly when extreme ratings require further explanation or measurement (Sink and Sahl, 1995).

Closely related to central tendency is the problem of leniency. Leniency transpires when managers do not use the low ratings in order to avoid conflict (Applebaum and Shapiro, 1991; Zemke, 1985).

The halo effect is another common rating error. This results when an employee’s performance in one area affects the ratings of other areas (Zemke, 1985). Popular employees are rated more highly (Tudor et al., 1996).

Further examples of rating error, are when supervisors are mistakenly influenced by:

- i) recency: Supervisors focus on the most recent behaviour exhibited by the employee, rather than rating performance across the total appraisal period (Zemke, 1985).
- ii) constancy: Employees are rated in rank order, rather than being rated based on individual performance (Zemke, 1985).
- iii) the assertiveness of an employee: Assertive employees receive higher pay increases (Gupta and Jenkins, 1996).
- iv) stereotyping: Ratings are influenced by a person's age, sex, religion, culture or race (Tudor et al., 1996).
- v) length of service (Zemke, 1985).
- vi) supervisors who "guess when they aren't sure" (Zemke, 1985, p. 26).
- vii) favouritism and politics (Wisdom and Patzig, 1987).

The above rating errors tend to be unconscious rather than deliberate. However, a supervisor may deliberately "fix" ratings by giving the maximum increase possible to employees, "thereby guaranteeing himself [sic] a quiet life" (Brough, 1994, p. 26). This is more likely to occur when performance appraisals are linked to pay (Tudor et al., 1996).

It is clear therefore, that performance appraisals are faced with many difficulties, hence the plethora of criticisms. "One has to suspect that at least some of the criticism leveled against appraisal systems has its basis in simple frustration" (Zemke, 1985, p. 32). A factor that contributes to the problems with performance appraisals is the effect they can have on teamwork.

6.2. Teamwork

"The surest way to destroy cooperation and, therefore, organizational excellence, is to force people to compete for rewards or recognition, or to rank them against each other (Kohn, 1993, p. 58).

Pay for performance systems do not promote teamwork (Deming, 1986; Parnell, 1991), but instead create a "lone ranger" mentality (Wilkerson, 1995, p. 43). If employees are rewarded for individual performance, they will be unlikely to work as part of a team to improve the processes of their company (McConnell, 1991;

Deming, 1986). Further, the “openness, trust [and] joint problem solving” an organisation has will be diminished (Applebaum and Shapiro, 1991, p. 32).

Pay for performance may also have the effect of dividing a workforce into those who support the system and those who do not (Applebaum and Shapiro, 1991). Flannery et al. (1996) separate employees into three groups. The first third will embrace the system eagerly. The second third will be more cautious and will wait until the system proves itself, with the remainder of employees being critical of the system regardless of its effectiveness. One group that has been particularly critical of pay for performance are the unions.

6.3. Union Attitudes

A potential problem when introducing pay for performance systems is union attitudes (Kinnie and Lowe, 1990). A union can have a levelling effect “on a pay structure” (Balkin, 1989, p. 303) and this is inconsistent with the pay for performance philosophy. Unions have historically been opposed to pay for performance (Gross and Bacher, 1989). A major objection of the unions, is once a pay for performance system is introduced unions can be isolated or removed from pay negotiations (O’Connor, 1994). When a pay for performance system is introduced the unions are effectively “impotent, since for the purposes of wage increases, all wages [become] performance based” (Proctor et al., 1993, p. 154).

Unions are also critical of the often-subjective nature of performance criteria (Anonymous, 1996b; Balkin, 1989). The union involved in negotiations with the BBC believe pay for performance is “inherently unfair and *cannot* be administered to ensure that discriminatory practices do not creep in” (Anonymous, 1996b, p. S8 [emphasis added]). Unions prefer objective measures of performance, and those that promote teamwork (Balkin, 1989). For this reason unions are not as vehemently opposed to group performance based pay plans as they are towards individual ones.

7. SUMMARY

Pay for performance is a concept that has evolved from circa 18th century B.C. and is supported by equity and expectancy theories. The term pay for performance now

refers to a plethora of systems, some of which do not truly pay an employee for their performance, but are viewed as entitlements.

Before deciding to adopt a pay for performance system, an organisation must be aware of the associated advantages and disadvantages. An organisation may find once a pay for performance system is implemented they have a stronger focus on strategic objectives, organisational performance is improved and they are more responsive to their environment. Conversely, there are major criticisms about the performance management process, the effect on teamwork and the response from unions. Further concerns are regarding:

“improper design and implementation; difficulties in paying for individual performance; lack of conviction on the part of workers that pay is really linked to performance; and inadequate or inappropriate objectives, criteria, and measures” (Lowery et al. (1996) p. 27).

Many of these disadvantages may be reduced or avoided altogether by addressing design and implementation issues of a pay for performance system.

Chapter 3

Design and Implementation of a Pay for Performance System

1. INTRODUCTION

Once an organisation has determined the advantages of introducing a pay for performance system outweigh the disadvantages, the attention will then turn to design and implementation. Communication, employee involvement and management support play a pivotal role in both phases. Design of a pay for performance plan is a complex task (Goodstein, 1988). An organisation must undertake a thorough review to determine the type of system that will best suit its unique circumstances (Applebaum and Shapiro, 1991). This chapter examines the above decisions and identifies guidelines for developing goals, performance measures and performance appraisals. Finally implementation issues are discussed.

2. COMMUNICATION, EMPLOYEE INVOLVEMENT AND MANAGEMENT SUPPORT

No matter how a new pay system is promoted, the concept of cutting base pay and replacing it with performance based pay will alarm most employees. Creating this unstable atmosphere may be necessary in order to lead a poor performing organisation to a new level of accountability (McSparran, 1993). A “compensation system must not only *be* fair, reliable, and valid; it must also be *perceived* as fair reliable and valid” (McGinty and Hanke, 1989, p. 15). It is the employees’ perceptions of a pay for performance plan that determines its ultimate success (Gomez-Mejia et al., 1985). Communication, management support and employee involvement each have a positive relationship with a plan’s success (McAdams and Hawk, 1993). They are necessary before, during and after the design and

implementation of a successful pay for performance plan, regardless of how well it is designed (McAdams and Hawk, 1993; Sink and Sahl, 1995).

2.1 Communication

“Putting a plan out there without the communications piece would be like investing \$10 million in a piece of equipment and never turning it on” (Livingston, 1998, p. 22).

The purpose of a pay for performance plan is to communicate what is critical to an organisation’s success (Berger and Moyer, 1991). However, when a system is introduced this often highlights the inadequacies of existing communications (Kinnie and Lowe, 1990). Communication’s role is as pivotal as design to the efficacy of a pay for performance plan. Without effectively communicating details of a new pay system from the outset, employees are likely to resist the plan and that resistance will be difficult to overcome (Sahl, 1994a).

Effective communication will increase employees understanding and acceptance of a plan (Merchant and Riccaboni, 1990; Sahl, 1994a; Wisdom and Patzig, 1987). If a reward system is easy to understand, the motivational value of the system will increase (Tang et al., 1987). The more complicated a pay for performance plan, the more important it is to allocate resources to communication and training (Gandossy and Scheffel, 1995). Communication about a plan must be clear and regular (Berger and Moyer, 1991) and should:

- “Tell people what you are going to do.
- Tell them what you are doing.
- Tell them what you have done” (Sahl, 1994a, p. 48).

The more frequent the communication, the better the results (McAdams and Hawk, 1993). Another way to improve communications is to involve employees in the pay for performance plan’s design and implementation.

2.2 Employee Involvement

Employee involvement is an:

“extension of the power to make decisions and of business information, rewards for performance, and technical and social skills to the lowest levels of the organization” (Ledford, Jr., 1993, p. 143).

Involving employees in improving an organisation's performance is the "key to competitiveness" (McAdams, 1995, p. 54). Further:

"[i]f the plan is well designed, well communicated, and thoroughly supported, the experience can be positive and rewarding not only for the company but for the individual as well" (p. 77).

Commitment and support for a pay for performance plan is increased when employees are involved in its design (Gross and Bacher, 1993; Merchant and Riccaboni, 1990; Romanoff, 1989; Wisdom and Patzig, 1987; Yakovac, 1996). McAdams (1995) found when non-management employees were involved in the design of pay for performance systems, non-financial results, such as business performance, teamwork and the performance reward link, were improved. This provides support for the notion that involving employees in the design helps instil a sense of ownership of a new system (McAdams, 1995).

Ownership increases, along with acceptance and understanding of the new pay system, when management and employees are involved in the design of their compensation system (Cumming, 1988). The overall effectiveness will be further enhanced when a personnel representative acts as a consultant to this process (Cumming, 1988). As an example, if goals and measures are set autocratically, then the pay for performance system will not work (Rondeau, 1992). However, should a taskforce of employees influence the setting of goals and measures, satisfaction with the system will increase (McAdams and Hawk, 1993).

The benefits of employee involvement are also evident when employees are involved in the implementation of a system. McAdams (1995) discovered when non-management employees were involved in the implementation of a system, satisfaction, business performance, teamwork, and the performance reward link, were all improved. This may be a flow-on effect from being involved in the plan's design. Italian motor vehicle company, Fiat, experienced minimal resistance to the implementation of their system because managers were involved in the plan's design (Merchant and Riccaboni, 1990). In view of the above factors, it is imperative that there is a strong emphasis on communication and involvement when designing and implementing a pay for performance system.

2.3 Management Support/Leadership

“History teaches that without effective leadership at the top, the rest of the organisation will struggle to improve” (Longenecker and Gioia, 1994, p. 5).

Strong leadership influences the success of a pay for performance plan (Longenecker and Gioia, 1994). A plan is more successful when a monomaniac drives the process (Gandossy and Scheffel, 1995), for without this forceful leadership an organisation will not achieve its objectives (Johnson, 1992). Such leadership is evident in top management, who introduce or champion the majority of pay for performance plans (McAdams, 1995).

Support from the Board of Directors (or equivalent) and top management for the process of change is crucial to the success of a new (or revised) plan (Berger and Moyer, 1991; Kinnie and Lowe, 1990; Morris, 1996). This support is so critical, a plan should be revised until approval is forthcoming (Tang et al., 1987). The role of the Board of Directors and top management continues to be important through the implementation phase (Berger and Moyer, 1991). There is a positive relationship between *public* expressions of support by managers and the non-financial results of the plan (McAdams, 1995). Employees must be informed of the plan's progress and be aware that management continues to pledge their support and alliance to the system (Berger and Moyer, 1991).

3. DESIGNING A PAY FOR PERFORMANCE SYSTEM

“When asked for a solution to a compensation issue facing a major corporation, a leading compensation strategist responded “What other problem would you like me to create” ” (Goodstein, 1988, p. 68).

Pay for performance is not a panacea, however, organisations can benefit from its motivational value when the system is used appropriately (Stewart et al., 1993).

A universal pay for performance plan can not meet the needs of all organisations or employees (Applebaum and Shapiro, 1991). Each organisation has unique requirements driven by their individual circumstances. Thus, organisations are urged to tailor their pay for performance plan in order to maximise their effectiveness (Applebaum and Shapiro, 1991; Krajci, 1990; Postrel, 1993; Silburt, 1987). Further, any design should be customised to suit different positions within an organisation

(Cumming, 1988).

A new compensation system must be integrated with other organisational changes and support change initiatives (Bunyan and McGill, 1997; Flannery et al., 1996). The introduction of a pay for performance system should be only part of a more comprehensive organisational change strategy (Giblin and Kelley, 1994). If a compensation system is introduced in isolation it will founder (Brough, 1994).

A popular approach has been for organisations to take a strategic view when designing their pay for performance systems (Milkovich, 1988). This strategic approach is based on three premises:

- i) “compensation policies and practices differ widely across organizations and across employee groups within organizations” (Milkovich, 1988, p. 263);
- ii) “decisions managers and employees make help shape these differences” (p. 264); and
- iii) “fitting compensation systems to environmental and organizational conditions makes a difference” (p. 264).

Such a belief is based on contingency theory, where decisions are contingent upon various factors (Milkovich, 1988). The premise being, an organisation’s strategy and its compensation strategy should “fit” each other (Milkovich, 1988, p. 282). The compatibility of these two strategies influences an organisation’s performance (Milkovich, 1988). However, the task of matching these two strategies has been likened to “shooting at a moving target” (Milkovich, 1988, p. 283).

This concept of matching has been extended to encompass:

“congruence between goals that organizations seek, strategies that are most likely to attain those goals, cultures that support these strategies and reward systems that elicit and maintain behaviors that are consonant with the appropriate competitive strategy and its supporting culture” (Muczyk, 1988, p. 225).

A careful analysis of an organisation and its environment is an essential first step when designing a pay for performance plan. Examination of a number of internal and external factors will guide a firm towards the most suitable pay for performance plan. This will help ascertain potential organisational barriers to implementing an equitable and effective pay for performance system (Dulling, 1996).

3.1 Internal factors:

“Obviously even the best conceived pay plan won’t make a company truly effective. Though effective pay plans can help focus and reinforce employee efforts, they cannot compensate for an absence of strategic planning, effective leadership, a positive corporate culture that builds employee commitment to the enterprise, sound financial management, an innovative marketing strategy, or solid investment strategy” (Giblin and Kelley, 1994, p. 43).

An organisation that uses a pay for performance plan “without regard to the establishment and maintenance of the proper organizational climate is analagous to planting crops in a paved parking lot” (Wisdom and Patzig, 1987, p. 27).

When introducing (or revising) a compensation programme, the organisation’s culture must be taken into consideration (Anthony and Govindarajan, 1995; Applebaum and Shapiro, 1991; Stewart et al., 1993).

Culture is defined as:

“a broad mixture of management practice, organisational structure, reward systems, employee characteristics, technological resources, access to information, decision making and standards of performance” (Bunyan and McGill, 1997, p. 12).

The culture of an organisation is akin to the personality of an individual, and has been referred to as “how the organization feels to outsiders, its procedures and practices, how it reacts to event and deals with problems” (Brough, 1994, p. 29).

In order to determine the ‘personality’ of an organisation, a survey of employees is commonly conducted (Gross and Bacher, 1989; Kanin-Lovers, 1987). Establishing the current culture of an organisation is a critical success factor when designing an effective pay for performance plan (Flannery et al., 1996). So too is the culture of the organisation’s society. Those individuals in instrumental cultures (e.g. USA) will perform at high levels when they are satisfied with the connection between effort and performance, and performance and rewards. Employees in instrumental cultures are “preoccupied with immediate gratification” (Muczyk, 1988, p. 226). In normative cultures (e.g. Japan), high performance is more likely to be caused by values, such as loyalty and commitment to the organisation, as opposed to being motivated by an incentive (Muczyk, 1988).

Culture is particularly important in public sector organisations, for pay for performance is often only one of a myriad of changes designed to change the

organisation to be more responsive to its environment (Brough, 1994). Often organisations will find a proposed compensation system is not appropriate for particular sections of their workforce (Claman, 1998), or the entire organisation (Lawler, 1981). The “cultural readiness” of an organisation for pay for performance can be a determining factor in the plan’s success (Gross and Bacher, 1993, p. 53).

Another factor that contributes to the success or failure of a pay for performance plan is the setting of quality corporate objectives (Geske, 1989). The best pay for performance plan will not compensate for poor objective setting (Geske, 1989). Similarly, should the strategies to achieve organisational objectives be misguided, this will have a negative effect on the organisation that no compensation system can neutralise (Perry, 1988).

At different stages of its life cycle an organisation will have different strategies and objectives (Stewart, 1993). For instance, when an organisation is “in a survival or turnaround mode” the redesign of a compensation system may not be a high priority for management (Applebaum and Shapiro, 1991, p.36). A pay for performance system should be appropriate to the organisation’s current life cycle (Stewart, 1993). Further, the system should be compatible with other management control systems (Anonymous, 1988; Tang et al., 1987) and other components of the pay system (Young, 1990). All elements of the compensation package should work together to achieve the same objective (Young, 1990).

An employee’s base pay influences their perceptions of an incentive payment (Ash, 1993; Meehan, 1992). Should the base salary be inadequate, any performance payment will be viewed as an entitlement (Ash, 1993). This belief will not reinforce the performance reward link (Meehan, 1992). If salaries are not competitive they should be increased rather than trying to use a pay for performance system as a counterbalance (Fowler, 1988). Pay for performance works well when base pay is competitive (Meehan, 1992). What is competitive depends, in part, on factors external to the organisation.

3.2 External factors:

The environment an organisation is facing is shaped by elements such as:

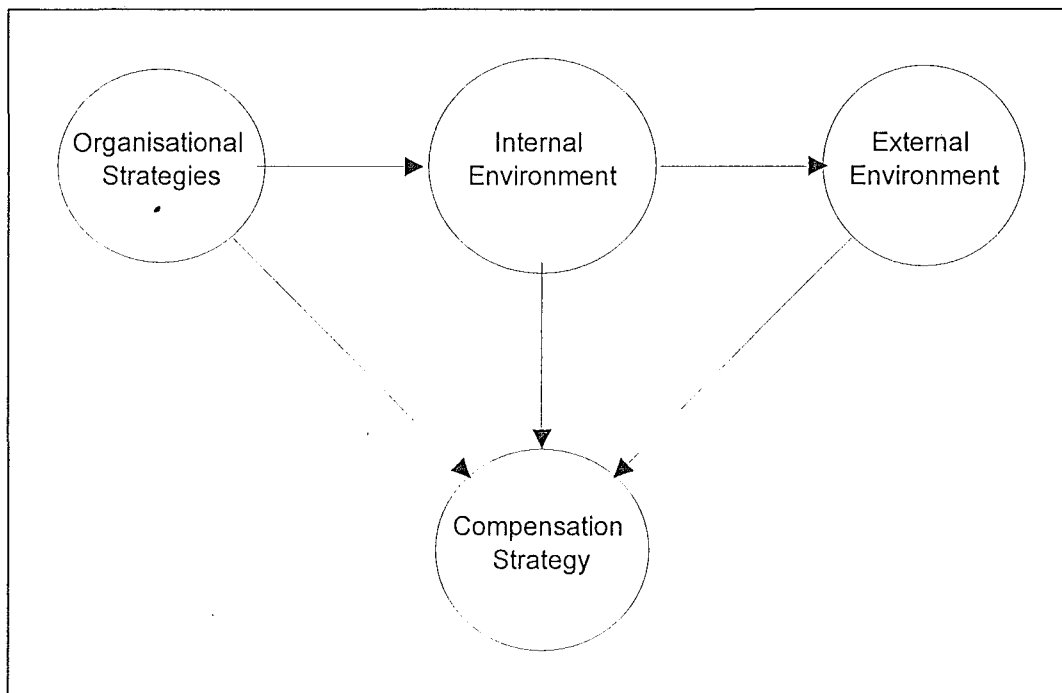
- i) Tax and legal issues (Anthony and Govindarajan, 1995);
- ii) Industry and competitor pay practices (Anthony and Govindarajan, 1995; Milkovich, 1988);
- iii) Unionisation (Haubrich, 1994; Milkovich, 1988); and
- iv) The organisation's industry and its competitive position within it (Haubrich, 1994).

Together these factors influence compensation strategy (as illustrated in Figure 1, page 34), and thus the designs of the most appropriate pay for performance system for an organisation.

While an effective pay for performance system should be tailored to each organisation, there are a number of general design and implementation principles. These are equally relevant to both public and private sector organisations, and include axioms to guide the setting of objectives, the design of goals, performance measures, and performance appraisals (Lowery et al., 1995).

Figure 3-1 - Determinants of compensation strategy

(Adapted from Milkovich, 1988, p. 274)



3.3 Objectives

An organisation must be clear about what it plans to achieve by implementing a pay

for performance system. There are two benefits to establishing these objectives prior to system design:

- i.) “The design and implementation of the plan can be structured to make it more likely that the goals are accomplished...
- ii.) by having clear objectives the organization can regularly measure how successful the plan is” (McAdams and Hawk, 1993, p. 53).

Wallace²⁸ found, out of six organisations that had no clear objectives for introducing their pay for performance plans, all six plans failed.

Rigg (1992) believes the motivation behind pay for performance systems is to “link action and performance to reward and to motivate the team to satisfy the organizational goals” (p. 27).

However, an organisation will rarely have a single objective when implementing pay for performance (Mandt, 1984). Objectives may also be to:

- i) Align the organisation’s compensation with its cost structure (Giblin and Kelley, 1994);
- ii) Recruit employees that fit the organisation’s culture (Lederer and Weinberg, 1996; Mandt, 1984);
- iii) Reward outstanding individuals and team performance (Lederer and Weinberg, 1996);
- iv) Inspire superior performance (Lederer and Weinberg, 1996); or
- v) Provide an organisation with a competitive advantage (Ash, 1993).

It is important that all objectives are acknowledged so the optimal pay for performance plan may be designed for the organisation (Mandt, 1984).

3.4 Performance Management

A performance management system is made up of goals, performance measures and performance appraisals (Brough, 1994)²⁹. It is further affected by an organisation’s communication systems, strategies and objectives (Stewart, 1993). It is essential that

²⁸ Cited in Perry (1988), not referenced.

²⁹ For a more comprehensive definition of performance management, see Chapter 2.

these elements work well together *before* incentives are introduced (McDermott and Hackett, 1997). For some organisations this may mean areas that are not operating effectively are identified and changes are made (McDermott and Hackett, 1997). Flannery et al. (1996) believe the performance management programme should run for 12 to 18 months without the pay programme. This enables the organisation to refine the system, ensure equitability and nurture the type of culture necessary for the new pay plan to work as intended (Flannery et al., 1996). Due to the sensitive nature of the pay system, changes should be made cautiously, over a time frame that is suitable to the individual circumstances of the organisation (McSparran, 1993).

3.5 Goals

The starting point for designing the goals for a pay for performance system is with an organisation's business plan. This plan should state the organisation's goals, objectives and strategies (Ross, 1988) and support the organisation's mission statement (Sink and Sahl, 1995). From this, individual or team goals can be determined that will be linked to the organisation's strategic objectives (Dyment, 1987; Kinnie and Lowe, Meehan, 1992; Minken, 1987; Romanoff, 1989; 1990; Sink and Sahl, 1995). This will help ensure goal congruence (Tang et al., 1987).

In practice, this will mean goals will include short and long term objectives (Haq, 1995; Sink and Sahl, 1995; Tang et al., 1987), divisional and organisational goals (Kay and Lerner, 1995), and contain a balance of quality and productivity targets (Ricciardi, 1996). In order to have optimum motivational value, goals must also meet the following criteria. They must be:

- i) achievable. If goals are not achievable then employees will become discouraged and unmotivated (Liccione, 1997; Ross, 1988);
- ii) controllable. (Minken, 1987; Ross, 1988; Yakovac, 1996); and
- iii) clear. An employee will not know how to achieve a goal that is unclear (Liccione, 1997; O'Connor, 1994). If a manager believes this is impossible "it should be pointed out that if that were true, they would be unable to distinguish between their best performers and worst performers" (Liccione, 1997, p. 20).

It is important that there are not too many objectives or employees will be unsure of

the organisation's priorities (Macaulay and Cook, 1994). Between three and five factors critical to the success of the organisation should be utilised (Livingston, 1998). Establishing appropriate goals is essential to the success of a pay for performance system, for they form the very foundations on which the plan is built (Lowery et al., 1995). However, equally important is the selection of performance measures (Heneman, 1992).

3.6 Performance Measures

"Rewarding performance without measuring results is like paying the winner of a game, but not telling the players how the score is kept" (McSparran, 1993, p. 119).

Choosing meaningful measures, to determine whether a goal has been achieved, is a formidable task. As with goals, performance measures should be controllable (Tang et al., 1987). Kaplan (1984) believes the selection of performance measures is an art.

Public sector organisations are faced with unique challenges when determining performance measures (Wisdom and Patzig, 1987, p. 130):

- i) Many public sector organisations operate in the service sector where choosing meaningful performance measures poses a particular challenge (Wisdom and Patzig, 1987); and
- ii) The absence of a profit motive as an impetus for outstanding performance, and therefore, as a benchmark for measurement (Wisdom and Patzig, 1987).

There is a growing awareness that accounting measures such as return on investment and earnings per share may not reflect an organisation's success (Young, 1990). Further, using solely accounting measures will not reflect the diversity of an organisation's strategic goals (Haq, 1995). An organisation will need to tailor performance measures to suit each type of position in an organisation (Cumming, 1988). In most cases, multiple measures of performance are essential to reflect an employee's performance (Tang et al., 1987). There is some disagreement as to the optimal number of measures of performance, however, there should not be too many (Smith et al., 1987). It has been suggested there should be as many measures as necessary (Anonymous, 1988), however, Zemke (1985) contends between four and

ten measures are optimal. All major job aspects should be measured (Gupta and Jenkins, 1996).

Performance should be measured using results rather than using subjective personality traits (Romanoff, 1989). While personality traits, such as enthusiasm, leadership, ambition and discipline, may give some indication of success, they are not synonymous with success. People may possess the traits, and still not be successful. Basing performance measures on traits also assumes that they can be changed easily, whereas in reality it is a slow and difficult process (Romanoff, 1989).

Performance measures may be based on productivity, however, it is important to include a quality component (Ricciardi, 1996). This can be difficult as many of the quality goals necessitate the use of subjective criteria. Further, a performance system which uses a lot of unverifiable subjective criteria will often come under close scrutiny and criticism from unions, and employees (Lowery et al., 1996). However, contrived measures will eventuate when objective measures are unduly stressed (Meehan, 1992). Weighting objectives such as productivity and quality according to importance will make clear to employees exactly what is important to the organisation, and the importance of each objective (Geske, 1989, Sink and Sahl, 1995). The key is to use a balance of measures (Tang et al., 1987).

Objective criteria should be used where appropriate and where subjective criteria are used they should be clearly communicated so both the appraiser and the appraisee have the same view of what performance is expected (Ross, 1988). It is essential that training be provided for all managers who are assessing subjective or behavioural criteria³⁰. This will aid understanding of the objectives (Sink and Sahl, 1995). To minimise the potential bias involved in using subjective criteria, multiple sources of performance data can be obtained (Rondeau, 1992). 360° evaluations, where employees are rated by people above and below them in the organisation (Kerr, 1996), may be used for this purpose (Ricciardi, 1996; Wilkerson, 1995). Gandossy and Scheffel (1995) assert “[i]t is far better to roughly measure the right thing than to precisely measure the wrong thing” (p. 36).

³⁰ The issue of training is covered in section 4.

Performance measures are not static, but rather should be considered part of a dynamic process (Ricciardi, 1996). Performance measures should be reviewed and updated regularly, to keep in line with changing positions and objectives of the organisation (Meehan, 1992; Sink and Sahl, 1995). If the above suggestions are followed, clear and meaningful objectives will be produced, confidence will be instilled in the measurement process, and employees will be more satisfied (Wisdom and Patzig, 1987). Still, there must also be confidence in the performance appraisal process.

3.7 Performance Appraisal

A fair and effective performance appraisal is another prerequisite to reinforce the link between an employee's performance and their reward (Muczyk, 1988). The overriding purpose of performance appraisals is as a tool to encourage continuous improvement (Sahl, 1994b). The performance appraisal should be used to prompt discussions about current performance (Zemke, 1985), determine areas of weakness that can be improved through training, and evaluate the effectiveness of past training (Tudor et al., 1996). A performance appraisal should also serve as a justification for personnel decisions such as "promotions, demotions and terminations" (Tudor et al., 1996, p. 41). Without such a system, an organisation may face legal difficulties should an employee challenge the validity of, for example, the choice of employee for promotion (Tudor et al., 1996; Zemke, 1985).

Performance appraisals are particularly important at lower levels of an organisation (Kinnie and Lowe, 1990). They should be used as vehicles to improve communication and trust between the employee and manager (Kinnie and Lowe, 1990). Multiple sources of data should be used to appraise an individual's performance (Gupta and Jenkins, 1996). As noted earlier in the Chapter, this may be achieved through use of 360° evaluations, for this encompasses the perceptions of an individual's supervisor, peers, customers and subordinates (Whitney, 1988). Using multiple sources of performance data will reduce the occurrence of rating error (Gupta and Jenkins, 1996).

Following an appraisal interview between a supervisor and the employee there should be a mutual understanding as to the actions required to improve the

employee's performance (Sahl, 1994b). These sessions should be constructive with an emphasis on continuous improvement (Sahl, 1994b). An employee should receive regular feedback on job performance and this should not be restricted to the appraisal interview (Guinn, 1987). Regular coaching by a manager "eliminates the often unpleasant and unproductive postmortem aspects of performance appraisal" (Guinn, 1987, p. 41-42). In order to reinforce the behaviour encouraged by an organisation, there should be frequent performance appraisals (Silburt, 1987). The ideal frequency will differ for each organisation, as there is often a trade-off between the occurrence of performance appraisals and the cost of performance measurement (Johnson, 1992).

Following the introduction of a performance appraisal process the results must be regularly monitored (Gomez-Mejia et al., 1985; McAdams and Hawk, 1993). Without this "quality-assurance feature" the system may regress (Gomez-Mejia et al., 1985, p. 79). Many performance appraisals lack credibility, but this is due to insufficient efforts rather than a lack of knowledge (Muczyk, 1988). As detailed in Chapter 2, the main problem with performance appraisals is that of rating error. Adopting a forced distribution system is one way many of the rating errors may be overcome (Smith et al., 1987).

A forced distribution system restricts "the percentage of employees who can be assigned a rating" (Meehan, 1992, p. 48). This 'forces' the allocation of ratings to follow a set distribution, thereby diminishing the rating errors that can often distort performance appraisal systems (Smith et al., 1987). Prior to the introduction of a forced distribution system at Research Cottrell Inc., 61-82% of employees were rated in the top two performance categories and the lowest category was not used (Smith et al., 1987). Upon the addition of a forced distribution system to the Company's redesigned compensation plan, ratings were "more realistically and usefully distributed" (Smith et al., 1987, p. 20). Often this means the allocation of ratings follows a normal distribution similar to the general population, i.e. follows a bell shaped curve (Wilkerson, 1995).

Major criticisms stem from the assumptions behind normal distribution. Normal distribution assumes the random selection of new employees, the position in which to place them, and in the choice of promotions (Wilkerson, 1995). Fowler (1988)

asserts in a successful pay for performance plan the number of employees in the top rating categories should increase over time. However, the static nature of forced distribution allows no movement to reflect the benefits of training, employee empowerment or reinforcement (Wilkerson, 1995). Fowler (1988) notes “if all a scheme does is to perpetuate a natural distribution of performance standards, it would not seem to be having any effect whatsoever” (p. 34). Additional criticisms of forced distribution systems are:

- i) The link between performance and reward is tainted (Meehan, 1992);
- ii) Ratings tend to be correlated with an employee’s position and seniority (Meehan, 1992);
- iii) By ranking employees this creates a climate of competition rather than one of teamwork (Meehan, 1992); and
- iv) The validity of the performance appraisal is diminished. When explaining appraisal results, managers may explain that although the employee rated excellent, the system will only allow a satisfactory rating. Not surprisingly this results in demoralised employees who have no faith in the pay for performance system (Sullivan, 1988).

Another means of reducing rating errors is to hold managers accountable for their ratings (Tudor et al., 1996). There is little incentive for managers to appraise employees in a careful, accurate and unbiased manner (Romanoff, 1989; Meehan, 1992). How well a manager encourages and assesses the performance of employees should form a large part of any manager’s own performance appraisal (Romanoff, 1989). In order to deal with potential disagreements with appraisals, there should be an official appeals system (Krajci, 1990). This will enable perceived inequities in appraisals to be corrected and adjusted for (Tudor et al., 1996).

3.8 The Reward

Extrinsic, or financial, rewards are not the sole motivating factor behind outstanding employee performance (Rich and Florin-Thuma, 1990). Intrinsic rewards such as recognition and personal or professional development can also contribute to an individual’s motivation and should not be ignored (Bice, 1990; Kerr, 1996; Rich and Florin-Thuma, 1990; Ross, 1988). Intrinsic rewards are particularly valuable when

an employee has regular contact with customers (Bice, 1990).

Recognition is often undervalued as a motivator (Furlong, 1993). However, like other non-financial rewards, if they are used too frequently their effectiveness is diminished (Kerr, 1996). While intrinsic rewards, such as recognition, are important, they must be coupled with opportunities for promotion and equitable remuneration (Bice, 1990). Identifying rewards that will motivate employees is a difficult task (Applebaum and Shapiro, 1991) that must take into consideration individuals and their cultures (Kerr, 1996). Due in part to this, Fletcher Challenge now takes a “total compensation approach to compensating its employees in New Zealand” (Littlewood, 1995, p. 19)³¹. Employees are able to choose how their remuneration is to be paid (Littlewood, 1995). This may be any combination of wages and benefits that suit the individual’s unique circumstances (Littlewood, 1995). Such plans have been dubbed ‘cafeteria’ plans, where employees may choose benefits that they would like (Hodge, 1998).

Providing money as the incentive for an employee’s performance is “the most recognised means of reinforcement” (Parnell, 1991, p. 8). There are a number of options to consider when utilising this form of reward. Firstly, the size of the reward. To be effective, a reward must be substantial (Lederer and Weinberg, 1996; Rondeau, 1992; Whitney, 1988). It must be large enough to attract the attention of high achievers (Sink and Sahl, 1995). There is no consensus as to the definition of a substantial reward, however values range from 10 – 15% of base pay (Geske, 1989; Kerr, 1996; McSparran, 1993; Taylor, 1997). Rewards of less than 5% will rarely be effective as motivators (Silburt, 1987). The use of an uncapped incentive is a compelling motivator for employees (Johnson, 1996). However, an organisation that uses uncapped incentives is not protected against inappropriate goals (Johnson, 1996).

When pay for performance plans are funded at low levels, the effect can emulate that of forced distribution (Applebaum and Shapiro, 1991). However, the more communication and employee involvement within an organisation the less critical the

³¹ For a more detailed discussion of the circumstances that led Fletcher Challenge to develop its total compensation approach,

size of the reward (McAdams, 1995). A pay for performance plan that has been effectively designed and implemented should be self-funding (Anonymous, 1988).

The timing of the reward is also important (Kerr 1996; Smith et al., 1987). If the rewards are infrequent, the connection between pay and performance will be weak (Kerr, 1996; Whitney, 1988). A reward must therefore be conferred soon after it is earned (Smith et al., 1987). Further, the reward must be differentiated from base pay (Whitney, 1988). The reward is thus very important to the success of a pay for performance plan. However, the implementation of a plan has been viewed as more important than the plan itself (McGinty and Hanke, 1989).

4. IMPLEMENTATION OF A PAY FOR PERFORMANCE SYSTEM

Success of a pay for performance system is strongly influenced by how it is implemented (Lowery et al., 1995). However, failure to recognise the importance of implementation issues often leads to the demise of a plan (Gross and Bacher, 1989). Organisations should allocate approximately twice as much effort to the implementation phase as compared to design (Gross and Bacher, 1989).

Lowery et al. (1996) surveyed employees of a large company to assess their reaction to the implementation of a performance based pay plan. They found that overall the reaction to such a plan was very positive. However, there were some concerns with regard to the implementation aspect of the pay for performance plan.

As noted earlier in the Chapter, effective implementation will involve a strong emphasis on communication, employee involvement and management support. While managers may pledge support to the plan, they also need to be equipped with the appropriate skills. Training is, therefore, of particular importance.

4.1 Training

Sufficient training for managers is a critical success factor to achieving an effective pay for performance system, for effective performance appraisals are largely reliant

on the skill of supervisors (Martin and Bartol, 1986). Without the appropriate skills, particularly in the area of performance appraisal, a plethora of rating errors will occur (Martin and Bartol, 1986). Training of managers is as important to the accuracy of ratings, as the design of the ratings themselves (Zemke, 1985). When rating errors are reduced, so to is the potential future liability of the organisation (Tudor et al., 1996). The ongoing training budget should be three times that of design (Gandossy and Scheffel, 1995). The skill required to conduct effective appraisals can only be gained through training and practice (Gomez-Mejia et al., 1985). Managers should be trained in four areas. How to:

- i) Set goals and establish appropriate measures;
- ii) Evaluate employees and avoid rating errors;
- iii) Resolve conflict; and
- iv) Coach and counsel staff (Meehan, 1992).

Managers should provide comments to employees that are clear, constructive and positive (Romanoff, 1989). Managers should receive similar feedback about their rating performance, both from reviews of the system (Krajci, 1990) and their employees (Gross and Bacher, 1989). These reviews ensure the plan remains workable.

4.2 Review of the System

“Change is the only constant” (Meehan, 1992, p. 49).

The entire system should be reviewed regularly to ensure the plan is achieving the anticipated results (Gross and Bacher, 1989; Smith et al., 1987). A survey performed at regular intervals can be used as a gauge to measure aspects of the plan’s performance (Kinnie and Lowe, 1990). A review can also identify weaknesses (Tang et al., 1987) and review the distribution of incentive payments to keep the system equitable and workable (Krajci, 1990). This monitoring is often viewed as a continuous process that must keep pace with major changes in an organisation’s strategies, objectives and external environment (Tang et al., 1987). As Meehan (1992) asserts, “[i]t is essential that programs be constantly monitored to ensure that the conditions that enabled their success still exist” (p. 49). Organisations who do regularly review their pay for performance system found teamwork and business

performance was improved (McAdams and Hawk, 1993).

5. SUMMARY

An organisation that decides to design and implement a pay for performance system faces numerous challenges. Firstly, the organisation must be in a position to implement a system, with clear objectives, strategies and a supportive culture. The communication systems must be open, clear, and must encourage involvement from all affected sectors of the organisation. The potential plan must have the support of top management and should only be designed after a thorough review of the organisation.

Following the design of the goals, performance measurement and performance appraisals, it is recommended that this performance management system be implemented without a link to remuneration until the system is refined and running smoothly. This is estimated to take between 12 and 18 months. The success of implementation is strongly dependant on communication, employee involvement and training of staff.

Design and implementation decisions must be made while considering an organisation's unique internal and external environment. One system is not suitable for all organisations, or all sections within an organisation.

The development of a pay for performance system in Business Unit A of the Christchurch City Council is discussed in Chapter 5. The process Business Unit A followed was examined using the case study method, thus, Chapter 4 discusses the case study method.

Chapter 4

Research Method

1. INTRODUCTION

“The selection of a research topic and a corresponding method are in many ways...a life choice. They are indicative of that which the researcher believes is important to ‘see’ in the world, to investigate and know” (Rosen, 1991, p. 21).

This research has been conducted using the case study method. Hence, this chapter defines and identifies different types of case studies. The applicability of the case study method to this research will then be investigated, followed by a description of the method used to gain access. The specific data collection techniques and the data analysis are then examined.

2. CASE STUDY METHOD

2.1. Definition

Qualitative research:

“is an umbrella concept covering several forms of inquiry that help us understand and explain the meaning of social phenomena with as little disruption of the natural setting as possible. Other terms often used interchangeably are *naturalistic inquiry*, *interpretive research*, *field study*, *participant observation*, *inductive research*, *case study*, and *ethnography* (Merriam, 1998, p. 5).

This research employs the case study method. There is often a distinction made between the terms case study and field research. This is generally made on the basis of sample size. A case study is examining one unit or organisation, and field research two or more (Birnberg et al., 1990). However, as Ferreira and Merchant (1992) note:

“sample sizes should not be used as a distinguishing feature of field research, because sample sizes, particularly as they might contribute to statistical significance, are not a primary concern of the field researcher” (p. 5).

In this research no distinction is made between the terms case study and field research. The expression case study will be used.

There is no universally accepted definition of a case study (Cavaye, 1996). A case study is often defined with reference to its characteristics and associated strengths and weaknesses (Cavaye, 1996). This is illustrated in the following definition from Ferreira and Merchant (1992). In case studies:

- i) "The researcher has direct, in-depth contact with organizational participants, particularly in interviews and direct observations of activities, and these contacts provide a primary source of research data.
- ii) The study focuses on real tasks or processes, not situations artificially created by the researcher.
- iii) The research design is not totally structured. It evolves along with the field observations.
- iv) The presentation of data includes relatively rich (detailed) descriptions of company contexts and practices.
- v) The resulting publications are written to the academic community...Some [case studies are also] easily read and used by practitioners" (p. 3).

The importance of context to a case study researcher is illustrated by the following two definitions of case studies. Cavaye (1996) believes case research:

"aims for in-depth understanding of the context of a phenomenon, but does not (though may) define *a priori* constructs and relationships" (p. 229).

Yin (1994) believes:

"A case study is an empirical inquiry that

- investigates a contemporary phenomenon within its real-life context, especially when
- boundaries between phenomenon and context are not clearly evident" (p. 13).

Scapens, (1990) further distinguishes between different types of case studies, in particular accounting case studies. Five broad categories are posed:

- i) **Descriptive:** The objective is to provide a description of current accounting practice;
- ii) **Illustrative:** "New and possibly innovative practices" of particular companies are detailed (p. 265);
- iii) **Experimental:** Potential benefits and difficulties in implementing new

practices can be determined;

- iv) **Exploratory:** This type of case study is used to explore the reasoning behind particular accounting practices. Theory generated from these case studies may be subject to empirical testing at a later stage; and
- v) **Explanatory:** Theory is used to explain particular behaviour/practice.

A case study may fit into more than one classification, as the boundaries between each different category are blurred. This particular research fits into the descriptive and exploratory case study categories. It attempts to describe the practices of the Christchurch City Council (descriptive) and explores the decisions made by a Business Unit within the Christchurch City Council regarding how to design its remuneration system (exploratory).

A researcher may undertake a single case study, or may decide to use multiple case sites. This research employs the former method. Single case studies enable:

“the researcher to investigate a phenomenon in depth, getting close to the phenomenon, enabling a rich description and revealing its deep structure” (Cavaye, 1996, p. 236).

A single case study was the most appropriate for this research. There has been a dearth of research into the compensation practices of New Zealand public sector organisations. Adoption of the single case design enabled the researcher to provide an in-depth description of the design process of a Business Unit within a New Zealand local authority. Focussing on one case allows a researcher to deal with issues in more detail and with reference to their context within the organisation. Additional strengths of the case study method are examined in the following section.

2.2. Strengths of the Case Study Method

Over the past fifteen years management accounting researchers have been encouraged to undertake more case-based research (Drury and Tayles, 1995; Otley and Berry, 1994). The adoption of case research is seen as a necessary step “to bridge the gap between theory and practice” (Drury and Tayles, 1995, p. 268). There should be a nexus between academic and the practitioner worlds (McLean, 1988). This assertion is supported by Johnson (1992) who maintains “the most appropriate place to learn about business, and to research and develop theories about business is in places of business” (p. 189).

Management accounting research lends itself well to case research. As Bruns and Kaplan (1987) note:

“management accounting phenomena exist only in complex organizations, with their rich interaction of people, products, processes, markets, technologies, and cultures, it becomes extremely difficult to study the subject except in actual organizational settings; management accounting systems must be studied in the settings where they have been developed and where they function” (p. 2-3).

Further, Otley and Berry (1994) contend:

“in order to assess and evaluate the operation of management accounting and control systems, it is necessary to place them in their wider context. There is thus a *prima facie* case for the use of case-based research methods in developing a fuller understanding of the relative role of accounting and other controls in the management of organizational performance” (p. 46).

The design and implementation of a pay for performance system involves examining the organisation’s internal and external environment. Case studies are particularly powerful for examining contextually contingent issues such as this (Benbasat et al., 1987; Cavaye, 1996; Ferreira and Merchant, 1992; Ryan et al., 1992). Case studies are valuable tools to aid exploration of complex events (Benbasat et al., 1987; Peck, 1997; Yin, 1994). Adopting the case study method for this research has enabled the researcher to obtain detailed data about the pay for performance systems, that would not otherwise be publicly available (Ferreira and Merchant, 1992).

The type of research questions a researcher seeks to answer can give an indication of whether case research is the most appropriate method. Peck (1997) claims:

“an exploratory ‘What’ question, combined with explanatory ‘Why’ and ‘How’ questions ... suggest that a case study approach would be appropriate for the proposed research” (p. 17).

The research questions that this research investigates fit into these categories. The questions are:

- i) What is a pay for performance system?
- ii) What are the advantages of a pay for performance system in a New Zealand context?
- iii) What are the disadvantages of a pay for performance system in a New Zealand context?
- iv) What are the issues when designing a pay for performance system?
- v) What are the issues when implementing a pay for performance system?

These arguments endorsing the case study method provide strong support for the adoption and suitability of the case study method for this research. However, the choice of research method is not solely dependent on the fit between the topic and the chosen method:

“Ultimately, the reason for selecting one methodological approach over another is an issue of aesthetic choice, involved more with what a researcher desires to study than how she or he will do it. These choices involve a perception not only of what is ‘beauty’, but of the ‘truth’ underlying it” (Rosen, 1991, p. 21).

Critics of the case study method do not share this view. Four major criticisms are presented in the following section.

2.3. Criticisms of the Case Study Method

As with other methods, the case study does have its limitations. Failure to attend to these criticisms will restrict those “who will read or accept the results” and therefore prejudice “the dissemination and communication of the research” (McKinmon, 1988, p. 35). Many criticisms can be reduced, or avoided altogether, through careful design. However, as Ferreira and Merchant (1992) note there is an inherent limitation when one chooses the case study method:

“There is an obvious sample selection bias. Field researchers can study only organizations that are willing to be studied and these organizations may be unique in that they are proud of what they have accomplished, or they may have problems and are hoping for some input from an informed outsider” (p. 26).

The quality of research design is often determined by examining a number of criteria. Common criticisms are addressed in the following sections.

2.3.1. Internal Validity

Internal validity is concerned with the data analysis phase of the research and relates to the problems associated with making valid inferences (Yin, 1994). Internal validity also “deals with the question of how research findings match reality” (Merriam, 1998, p. 201). To be valid, an argument proposed by a researcher must be “more plausible than other possible arguments” (Numagami, 1998, p. 3). Establishing tactics to improve internal validity of case studies is a difficult task (Yin, 1994). The data analysis description in this Chapter illustrates how conclusions were reached in Chapter 5 and thus strengthens this aspect of the

research.

2.3.2. Construct Validity

Construct validity is addressed during the data collection and composition phases of the research (Yin, 1994). Construct validity questions whether data collection methods are appropriate and support the constructs within the research (Cooper and Emory, 1995; Numagami, 1998). Collection of multiple sources of data will provide triangulation for findings and strengthen the construct validity of the research. Furthermore, when findings are reviewed by an interviewee, construct validity is increased (Yin, 1994). These methods were adopted by the researcher, and are further discussed in the data collection section.

Researchers who employ a qualitative research method must address the effects of human biases on data collection and interpretation (Merriam, 1998). Many criticisms of the case study method stem from potential researcher subjectivity (Bruns and Kaplan, 1987). There is a potential for bias on the part of the researcher and interviewee, and this decreases the construct validity of the research (Yin, 1994). Ryan et al. (1992) believe this is not something that can be avoided:

“Social systems are not natural phenomena, they cannot be understood independently of human beings and the researcher cannot be regarded as a neutral independent observer. The social reality must be interpreted by the researcher and, thus, case studies represent interpretations of the social reality. There can be no such thing as an ‘objective’ case study (pp. 125-6).

However, such biases can be controlled. How human bias was controlled in this research is addressed in Chapter 6.

2.3.3. Reliability/Replicability

The objective of reliability in a case study method is to:

“be sure that, if a later investigator followed exactly the same procedures as described by an earlier investigator and conducted at the same case study all over again, the later investigator should arrive at the same findings and conclusions” (Yin, 1994, p. 36).

The emphasis here is on reliable record keeping and planning. The use of a “case study protocol” is recommended as a method of dealing with the documentation problem (Yin, 1994, p. 37). A case study protocol is a “guide to the investigator in carrying out the case study” (Yin, 1994, p. 63). This research did not utilise a

protocol. However, at the inception of the research process a research proposal was written and presented to members of the researcher's department. This proposal was used as a reference throughout the research.

Replicability also deals with the issue of reliability. The difference is that when a study is replicated it is conducted in a different organisation. Otley (1996) contends replicability is not possible when conducting a case study:

"The nature of the phenomena being studied and the context in which they are set make it rather unlikely that cumulative and replicable results can be obtained; refinements in methodology will not significantly improve this situation because the problem is embedded in the nature of the situation being studied. Life is fundamentally not replicable".

Replicability was, therefore, not an objective of this research.

2.3.4. External Validity

External validity is concerned with establishing whether a researcher's findings are generalisable (Yin, 1994). Generalisability with regard to statistical significance is not an objective of this research, nor is it for many others adopting the case study method (Yin, 1994).

The case study method is not a monolithic method. "[It] can be applied and used in many different ways and ... is open to a lot of variation" (Cavaye, 1996, p. 227). The variation that this research has adopted is the interpretive approach.

The interpretive approach to management accounting research is based on the belief:

"that social practices...are not natural phenomena; they are socially constructed....This means that we should not be looking for universal laws and generalizations" (Ryan et al., 1992, p. 63).

Taking this view of a case study requires detailed accounts of organisational practices:

"in their historical...economic, social and organizational contexts. For this purpose, researchers adopt a holistic orientation in which accounting is studied as part of a unified social system and a picture is built up of the system's wholeness, i.e. how the various elements contribute to the 'individuality' of the system" (Ryan et al., 1992, p. 63).

The findings that flow from this type of case study can provide management accounting practitioners with a deeper understanding of the context their work (Ryan et al., 1992). This context will assist practitioners when managing the demands of

their role (Ryan et al., 1992). An investigation of the environment and culture of the case study organisation was considered important to this research. Furthermore, contextual factors were particularly salient when considering the design and implementation of a pay for performance system into Business Unit A of the Christchurch City Council (CCC).

3. THE CHRISTCHURCH CITY COUNCIL

3.1. Gaining Access

Initial contact with the CCC was made through a relative of the researcher who was employed by the CCC. This person approached a member of the Human Resources team to assess the support this organisation was willing to provide and briefly described the nature of the proposed research. Upon receiving a positive response, a contact name and telephone number were obtained. Initial contact was made via the telephone, where the researcher and the proposed research were introduced. A personal interview was then undertaken.

Following this interview, the interviewee sent an e-mail message to five members of Business Unit A's remuneration team, introducing the researcher and making them aware they would be contacted with a request for an interview. All requests for interviews were received positively and were conducted at the offices of the CCC. Interviews were also held with the Director of Human Resources and an Employee Relations Advisor. A total of eight people were interviewed.

The words 'interview', 'research' and 'publication' were rarely used, for these words are often viewed as threatening by respondents (Buchanan et al., 1988). Each interview began with an overview of what the researcher was 'interested in' and how the information gathered was to be used. To encourage truthful and candid responses, interviewees were assured of the confidentiality of their comments (Buchanan et al., 1988). Questions were elicited both at the beginning and end of the interview to ensure the respondents were comfortable with the interviewing process.

One year after the initial interviews were conducted the researcher revisited the site. Selected interviewees from the earlier research were contacted via email. This email served as an 'icebreaker' and re-acquainted the interviewees with the researcher and associated research. The email also stated the researcher would telephone to

determine their interest and availability for an interview. Responses to the initial email were positive and were received in the form of email and telephone calls from respondents. Interviews (both via telephone and in person) were then conducted. Three members of the Business Unit's remuneration team were interviewed and one Human Resource representative. A total of four people were interviewed in this phase of the research.

3.2. Data Collection

A feature of qualitative research, such as this, is the researcher is often the data collection instrument (Merriam, 1998). There are a number of advantages characteristic of this approach:

“the researcher is responsive to context; he or she can adapt techniques to the circumstances; the total concept can be considered; what is known about the situation can be expanded through sensitivity to nonverbal aspects; the researcher can process data immediately, can clarify and summarize as the study evolves, and can explore anomalous responses” (Merriam, 1998, p. 7).

However, as with other data collection tools:

“the investigator as a human instrument is limited by being human - that is mistakes are made, opportunities are missed, personal biases³² interfere” (Merriam, 1998, p. 20).

Data for this research was principally collected by interview. The interview has been noted as a “virtually infinitely flexible tool for research” (Breakwell, 1995, p. 230). The interview enables a researcher to “enter the other person's perspective” (Merriam, 1998, p. 72). An interview is often the only means of gathering the necessary data, particularly when:

“we cannot observe behavior, feelings, or how people interpret the world around them. It is also necessary to interview when we are interested in past events that are impossible to replicate (Merriam, 1998, p. 72).

Prior to conducting the interviews, questions were piloted on members of the researchers department to ensure the sensibility and logical flow of the questions. While the researcher had predetermined some questions, the interviews did not follow a set structure. This enabled the interviewer to follow additional lines of

³² Human biases are often present in interviews and are often viewed as an inherent limitation of case studies. They are covered in more depth in Chapter 6 - Limitations and Future Research.

questioning when appropriate (Breakwell, 1995).

Open-ended questions were utilised within each interview as it was recognised this approach reduces the constraints on answers (Breakwell, 1995; Lowery et al., 1996). The interview length ranged from approximately 20 minutes to one hour, with the longer interviews being with the human resource employees. Following completion of both phases of interviews, telephone and email contact was made to clarify and expand points the researcher became aware of while writing Chapter 5. The validity of data collected via interview increases when you talk to a person more than once, their “openness and honesty” increases (Breakwell, 1995, p. 239).

Interviews were not the sole method of data collection for this research. Multiple sources of evidence were utilised to increase the construct validity of the data (Benbasat et al., 1987; Yin, 1994).

“The goal is to obtain a rich set of data surrounding the specific research issue, as well as capturing the contextual complexity” (Benbasat et al., 1987, p. 274).

The types of data collected from the CCC are noted in Table 4-1 (page 57). How these sources of data were combined to form Chapter 5, is discussed in the next section.

4. DATA ANALYSIS

Following the collection of the data, ideas were grouped in a logical order and compared to the literature. This is commonly referred to as coding data (Dane, 1990). Care was taken when interpreting the interview data and where possible multiple sources of data were obtained.

In order to aid triangulation and accuracy of the findings, Chapter 5 was given to a member of the remuneration team to review. This is recommended as a tactic to “check whether [the results] make sense” (Breakwell, 1995, p. 242). The response from the interviewee was positive, with few corrections made to the final Chapter.

Table 4-1 - Data Sources from the CCC

Sources of Data from the CCC	
1.	Business Unit A Brochure
2.	Critical Path to Performance: A Users Guide
3.	Excerpts from a training document
4.	Human Resources Strategy Document
5.	Minutes of Business Unit A's Remuneration meetings
6.	Notes from Business Unit A's Remuneration meetings
7.	Outside Staff Collective Employment Contract
8.	Personal Interviews
9.	Personal Value Plan
10.	Relevant memorandum between key parties of the remuneration team
11.	Salaried Staff Collective Employment Contract
12.	Team Value Statement
13.	Training Module Documentation

5. SUMMARY

The case study method was the most relevant and applicable research method for this research. It enabled the researcher to describe and explore the decisions and practices of the CCC, and refer to the context and environment that the organisation faced. The criticisms of the case study method focus on validity (internal, external and contextual) and replicability. These criticisms are not considered relevant by all case study researchers, however, where possible tactics were employed to reduce prejudicial effects on the data and subsequent conclusions. Multiple sources of evidence were gathered in order to provide triangulation for the findings. One participant in the research reviewed and verified the findings in Chapter 5 and confirmed the researcher's interpretation of the data. These findings are presented in Chapter 5.

Chapter 5

The Christchurch City Council

1. INTRODUCTION

This research investigated the process one Business Unit, within the CCC, followed when managing their remuneration system, particularly with regard to pay for performance. To provide a context for the pay for performance system this chapter begins with the background of the CCC and the remuneration system at the inception of Business Unit A's design process. This is followed by a description of the process Business Unit A undertook when designing its system and the advantages and disadvantages of their approach. Finally the findings are compared and contrasted with the literature which was presented in Chapter 2 and 3.

2. THE CHRISTCHURCH CITY COUNCIL

Prior to 1989 there were over 700 local authorities throughout New Zealand. With the passing of the Local Government Amendment Act in 1989, the number was reduced to 85 (Pallot, 1997). In Christchurch, there had been five territorial authorities, and three ad-hoc local authorities. These were amalgamated on 1 November 1989, and became the CCC (Christchurch City Council, 1996a). Subsequent to the amalgamation, the CCC embarked on a period of change management. Between 1989 and 1993 change in the CCC focused on:

- restructuring the organisation and amalgamating employment contracts
- separating trading functions such as airport, electricity supply, public transport etc.
- reducing the staffing establishment by a third
- amalgamating existing budgets, changing the financial year and developing new budgeting processes
- developing public consultation processes
- zero rate increases for three years
- amalgamating and developing a new City Plan

- implementing other new legislation covering such diverse areas as resource management, building, employment contracts, health and safety, human rights etc.
- strategic planning, financial modeling and output budgeting etc (Christchurch City Council, 1996a, p. 3).

As a result of these initiatives, the CCC was awarded a prize for excellence in local government, by the Bertelsman Foundation of Germany in 1993³³ (Christchurch City Council, 1996a).

The appointment of a new City Manager in 1993, marked a further turning point for the CCC. The new City Manager took the opportunity to rethink where the organisation was heading. In doing so he asked the question:

“[H]ow do we continue to improve our productivity, to improve the quality and range of services to our customers without spending more money?” (Christchurch City Council, 1996a, p. 3).

The answer was to:

“[W]ork smarter, not harder, and we will achieve that if we change the organisational culture to release the talents and creativity of all our people” (Christchurch City Council, 1996a, p. 3).

At the time, the CCC utilised the *“old police and control model, where Business Unit managers were saved from crises of their own making”*³⁴. The Human Resources Department was cast in the role of *“knights in white horses”*. Organisational restructuring was therefore necessary as the “existing structure no longer aligned with [the CCC’s] new culture” (Christchurch City Council, 1996a, p. 4). As a result of this restructuring, the role of the Director of Human Resources was created³⁵. This position was to fulfil a “corporate-wide support and leadership role” (Christchurch City Council, 1996a, p. 4).

Following the restructuring, Business Units gained the autonomy to manage their own human resources and investigate different forms of remuneration. Accordingly, Business Units possessed the flexibility to:

³³ This prize was awarded jointly to both the CCC and Phoenix Arizona, USA.

³⁴ All statements quoted in italics are comments made by interviewees.

³⁵ Four Director positions were created - Finance, Human Resources, Operations and Policy. The Corporate Office was also established (Christchurch City Council, 1996a, p. 4).

“adapt existing and emerging models to their own needs, as long as these align with Giving Value - Being Valued and meet the corporate objectives of performance planning and management” (Christchurch City Council, 1997j, p. 5).

Each of the 34 Business Units within the CCC, could take the opportunity to review their current remuneration system and decide whether any changes were necessary. If change was warranted, the Unit had the authority to determine the type of system that would suit their individual characteristics. In theory, this meant each Business Unit could design and implement a different remuneration system. This autonomy extended to changing the base salary structure and implementing a pay for performance system. All changes to the Business Unit’s remuneration system were subject to the approval from the relevant unions and employees.

One interviewee justified this delegation of authority to Business Units by stating:

“Does it make sense to have a collective contract for 1200 employees working in very different areas? No. Therefore the Business Unit managers have the responsibility for their own human resources”.

Customising a pay for performance plan to suit an organisation’s individual circumstances will maximise its effectiveness (Applebaum and Shapiro, 1991; Krajci, 1990; Postrel, 1993; Silburt, 1987). Moreover, empowering Business Units in the area of remuneration provides:

“a greater opportunity to link pay with performance...an improved motivational effect to the pay program and ... greater responsiveness to rapidly changing organizational structures (Smith, 1992, p. 22).

It is important that all components of a pay system work together to achieve the same objective (Young, 1990). The two principle employment contracts within the CCC’s remuneration system are reviewed to provide context to Business Unit A’s decisions within their design process.

2.1. Remuneration System of the Christchurch City Council

An employee’s base pay influences their perceptions of an incentive payment (Meehan, 1992; Ash, 1993). Should the base salary be inadequate, any performance payment will be viewed as an entitlement (Ash, 1993). This belief will not reinforce the performance reward link (Meehan, 1992).

At the inception of Business Unit A’s process to design a pay for performance

system, the CCC utilised an organisation-wide remuneration system. However, *“this system did not suit the individual needs of the Business Units, and was not sending the right messages to employees”*. Thus, Business Units were able to investigate and implement a pay for performance system to suit their circumstances. When this research commenced, one Unit had implemented a Profit Sharing scheme and many Business Unit’s were yet to address remuneration within their Unit.

The organisation-wide remuneration system was characterised by its strong emphasis on collective employment contracts. Approximately 88% of employees were covered by four collective contracts and 12% by individual contracts. However, the traditional public sector contracts within the CCC, prior to restructuring, had slowly changed to reflect new developments such as broad banding³⁶, 360 degree evaluations³⁷ and, in one Business Unit, a form of pay for performance.

The two principle collective contracts within the CCC represented 84% of employees³⁸. These contracts provided the basis for determining base salary levels for employees within each Business Unit. A summary of these two contracts follows:

i) Salaried Staff Collective Employment Contract 1997/1999³⁹.

“The salaried staff contract uses a Watson Wyatt scheme that bases remuneration on levels from 90-110%. 100% is working at full efficiency. The movements from 90-100% are problematic in that there are automatic increments every six months”.

The increments from 90-100% were to continue until six monthly performance reviews were developed and agreed upon between the CCC and the union. Increases from 100-110%, known as merit steps, were made in increments of 2.5% and were subject to performance.

³⁶ As noted in Chapter 2, broad salary bands allow a manager to stay in one broad salary band for the duration of their career, rather than being dependent on a promotion for a change in salary (Labich, 1992).

³⁷ 360 degree evaluations allow employees to be rated by people above and below them in the organisation (Kerr, 1996),

³⁸ The remaining staff are represented by the Trades collective contract (3%), and the Shift Engineers contract (1%).

³⁹ This contract was developed in conjunction with the Southern Local Government Officers Union.

ii) **Outside Staff Collective Contract 1997/1999⁴⁰.**

Outside staff are waged employees who are members of the unions responsible for negotiating this contract⁴¹. The outside staff employment contract had two pay scales:

"Pay scale one was almost prescriptive, in that there were pay rates for a range of functions, and your pay scale would only go up if you changed your position. Pay scale two was aimed at encouraging staff to develop skills and expertise. Pay scale two provides the opportunity to move through the pay scale"

Following the introduction of pay scale two, employees covered by pay scale one could choose to remain on this scale or transfer to the new pay scale. All staff employed under the Outside Staff contract, after the introduction of the second pay scale, were automatically covered under pay scale two.

Both the Salaried and Outside Employment Contracts included *"a negotiated Consumer Price Index movement, that you get because of being a member of a union"*.

When referring to the CCC's organisation-wide remuneration system interviewees believed:

"There was a realisation that the present remuneration system rewards employees for the length of service";

"While there is a merit step⁴², if you hang around for long enough then you would get the merit step because the manager who assesses your performance would be too embarrassed not to award it";

"Once a year the manager looks at your performance and whether you are due for a merit step. It is based on certain criteria, but they are pretty hairy".

It was recognised there needed to be *"significant development regarding salary*

⁴⁰ This contract was developed in conjunction with the Amalgamated Workers Union of New Zealand, Transport and General Workers Union Incorporated, Service Workers Union of Aotearoa (Southern Region) and Canterbury Hotel and Hospital Workers Union Incorporated.

⁴¹ It is not compulsory for an employee to be a member of a union. Employees who elected to be included in the Outside Staff contract and were not a member of one of the contributing unions were listed in the appendices to the contract.

⁴² Each position within the CCC is assigned a grade, or grades. For example, Grade 12 of the salaried staff collective employment contract means you will receive between \$33619 and \$42378 per annum. There are between 10 and 11 steps within each grade. Each step within the grade means you are paid a different amount.

movement compared with performance". Furthermore, a change was required in:

"the mindset of employees, so there is no expectation of an automatic increase if 100% is reached. There needs to be change. Employees need to be rewarded for performance".

Movement of pay for performance into the public sector could not have occurred without a change in mindset⁴³ of these organisations (Fowler, 1988). In this instance, employees expected an increase in their compensation regardless of their performance. Automatic increments, such as those within the Salaried Staff Collective Contract, were a *"hang over from the State Public Sector mentality"*. This situation is not unique within New Zealand. The CCC was *"facing the same environment as any other local authority"*.

A compensation system that pays for attendance rather than performance is incompatible with a pay for performance environment (Muczyk, 1988). In a move recommended by Smith (1992), each Business Unit within the CCC was given the authority to develop their own remuneration system, thus providing a greater opportunity to link pay to performance. The new performance oriented culture of the CCC is described in the following section.

2.2. Pay for Performance and the Focus on Culture

Following the appointment of the new City Manager there was a stronger emphasis on pay for performance. *"The City Manager was leading from the top"*. However:

"rather than looking at pay for performance on its own, the CCC was looking at cultural change...there was a need to think about systems and the culture we wanted to create. Remuneration was part of that".

To facilitate the cultural change advanced by the new City Manager a number of initiatives were undertaken. These included:

- i) the establishment of a Performance Development System in late 1993/early 1994. This system was the CCC's version of a performance management system, and:

⁴³ 'Change in mindset' refers to the change in thinking required within the organisation. Employees must stop expecting automatic increases throughout their career (Fowler, 1988).

“[was] an on-going process of defining performance expectations, getting/giving feedback on performance, helping the ongoing development of team members, and documenting expectations and actual performance. [It was] an on-going cycle of communication rather than a once a year event” (Christchurch City Council, 1997a, p. 2).

The Performance Development System was gradually being superseded by value statements. These statements (as detailed below) were not a “new system”, but rather an “evolution” of the Performance Development System (CCC, 1997j, p. 4).

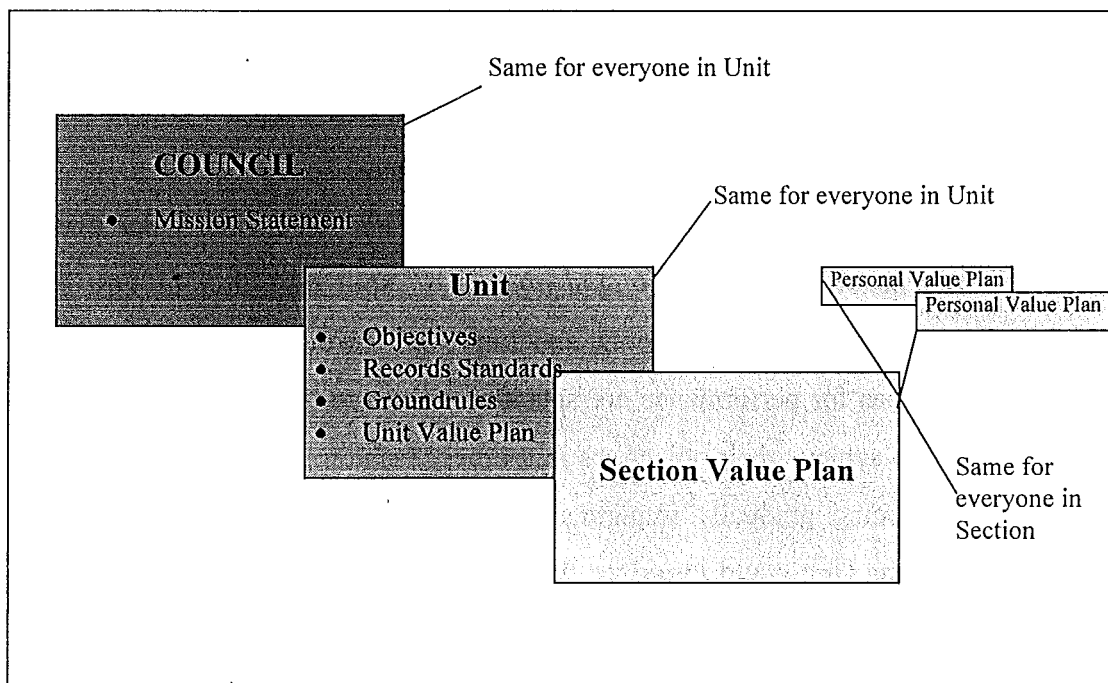
- ii) the development of the CCC’s cultural statement “Giving VALUE - Being VALUED” (Christchurch City Council, 1996a, p. 3)
- iii) the development of Team or Section Value Statements. This statement details the purpose of the Team, its overall objective and ties this to the Unit outcomes (Christchurch City Council, 1998). The Team’s customers are identified, along with the result that represents value to the customer, how the result will be achieved and how it will be measured (Christchurch City Council, 1996b).
- iv) the introduction of Job Value Statements. These were gradually replacing job descriptions, and flow from Team or Section Value Statements. They are generic statements and therefore do not differ between people in the same position (Christchurch City Council, 1998).
- v) the development of Personal Value Plans (PVP). A Personal Value Plan is “*a schedule of personal output objectives*” split into three groups: core outputs, project/team outputs, and improvement outputs. Standards and deadlines for performance are specified to ensure the Team and Unit are able to achieve their objectives in a timely fashion. Personal Value Plans were being gradually implemented throughout the organisation. Each Business Unit could introduce the concept of Personal Value Plan “*when they were ready*”⁴⁴.
- vi) the execution of a climate survey. A survey was conducted to determine the morale of the staff and their attitude towards working for the CCC.

⁴⁴ The philosophy of letting the Business Units move at their own pace is in line with the CCC’s decision to delineate human resource decisions to the individual Business Unit. This is discussed later in this Chapter.

The use of this type of survey is recommended as a means to determine the organisation's 'personality' or culture (Gross and Bacher, 1989; Kanin-Lovers, 1987). Establishing the current culture of an organisation helps to determine the most appropriate design for a pay for performance plan (Flannery, et al., 1996). On reflection, an organisation may find a proposed compensation system is not appropriate for particular sections of their workforce (Claman, 1998), or the entire organisation (Lawler, 1981).

As recommended by Anthony and Govindarajan (1995), the CCC made a concerted effort to align the objectives of the CCC and its employees. This was achieved through the use of the Unit, Section, and Personal Value Plans. Objectives in each of these plans were designed to support the CCC's overall mission statement. This is illustrated in Figure 5-1 (page 66).

Figure 5-1 - Alignment of Objectives within the CCC
(Christchurch City Council, 1996/97, p. 5)



This strong emphasis on culture and value is recommended for Public Sector organisations, as they are often coordinating multiple changes to their environment (Brough, 1994). It is vital that pay for performance is integrated with other change initiatives (Bunyan and McGill, 1997; Flannery, et al., 1996). If pay for performance

is introduced in isolation it will fail (Brough, 1994).

The changes made to the CCC's strategies, culture and structure were essential if they wished to positively influence their performance (Muczky, 1988). These initiatives redefined the culture of the CCC and provided an environment more conducive to pay for performance. Business Unit A used the Value Statements as building blocks to their pay for performance system. The process Business Unit A followed when designing their system is described in the next section.

3. BUSINESS UNIT A

Business Unit A was one of 34 Business Units within the CCC. It employed approximately 130 people. Each Unit was further split into Teams or Sections. In April 1997, Business Unit A began to review the current remuneration system, to determine whether another system, or modifications to the current system, would be more compatible its individual circumstances. A remuneration team was formed to undertake this review and develop a system that would suit their Unit.

Initially there was a call for volunteers for the remuneration team, however, this yielded only three responses⁴⁵. As there were so few volunteers, it was decided the managers of each of the five sections within the Business Unit should be part of the team. It is unclear why management were not included in the design of the pay for performance system from the outset, particularly when management support for a compensation system is pivotal (Berger and Moyer, 1991; Kinnie and Lowe, 1990; Morris, 1996).

The remuneration team was made up of the Business Unit Manager, five Section Managers within the Unit, a representative from the human resources department, and two other volunteers from Business Unit A. The role of the Personnel Officer in any Business Unit's remuneration meetings was dependent on Unit requirements. The Personnel Officer could be an active member of the team, or a facilitator. In this instance, the representative from Human Resources was a facilitator, or guide, for the process. This technique is advocated by Cumming (1988) who believes ownership

⁴⁵ The actual number could be more or less than three. The interviewee was not certain of the exact number.

and understanding of the system is increased when human resource employees are used in this way. Furthermore, commitment and support for a pay for performance plan is increased when employees are involved in the design (Gross and Bacher, 1993; Merchant and Riccaboni, 1990; Romanoff, 1989; Wisdom and Patzig, 1987; Yakovac, 1996). Employees are also more likely to understand and accept the new system when they have been involved in its design (Cumming, 1988).

In addition to the members of the remuneration team, representatives from another Business Unit were able to observe the remuneration meetings, to increase their knowledge and awareness of options that may be appropriate for use in their own Business Unit's remuneration plans.

Remuneration meetings began in April 1997 and continued until November 1997. The process followed in the subsequent seven meetings, was to help determine the optimal remuneration system for the Business Unit.

3.1. The Design Process

At the inception of the design process Business Unit A went into the remuneration meeting with a three-legged diagram (Figure 5-2, page 69). This diagram illustrated the three elements of the Personal Value Plan, and was a tentative blueprint for the remuneration system that would complement the Unit's circumstances. It was *"really the performance model for the organisation"*.

The first meeting of the remuneration team excluded the Human Resource facilitator, as this meeting was to discuss the direction the Unit was considering for remuneration. The Human Resource Representative was invited to the second remuneration meeting to provide guidance on the process the team should follow. At this meeting some members of the team were surprised to learn from the Human Resource facilitator that it was not wise to *"jump into"* the design of a system for their Unit without considering wider issues that affect the design of a pay for performance system. For some members *"the initial thinking was, what are we doing? Let's get down to the real stuff of designing the system"*.

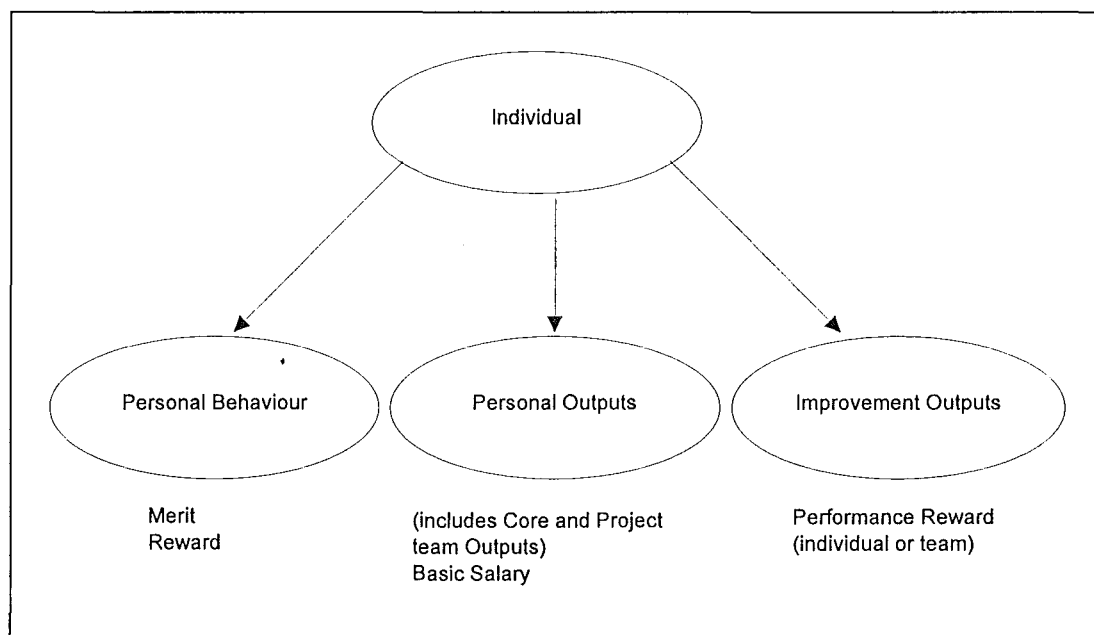
To illustrate why it was important to take a broader perspective, members of the team were asked a number of questions. Firstly, *"What is pay for performance?"*. As

with the definition of pay for performance provided in Chapter 2, responses were loosely grouped into two categories: the form of reward and the broad objectives of introducing the system. Members identified that pay for performance may:

- i) “change attitudes of employees
- ii) address poor performance
- iii) provide recognition
- iv) provide monetary reward” (Christchurch City Council, 1997k).

Figure 5-2 - Personal Value Plan

(adapted from Christchurch City Council, 1996/7, p. 5)



Secondly, when asked to stipulate specific objectives for implementing a pay for performance system in Business Unit A, it became apparent members were not clear on this issue. It was therefore agreed that the team should take a step back to:

“understand what we want to achieve; what the principles and purposes of pay for performance are in the Unit, and what the issues are in terms of integration, both with other groups of staff and other forms of reward”.

As one interviewee described:

“We went back to first principles, i.e. looking at the reasons why people want to implement pay for performance. Initially the focus was all on the money, the financial side, trying to link pay and performance. Now the focus has widened to look at lots of factors that affect performance”.

As it was noted in the minutes to this meeting, “the more things you try to achieve with pay for performance the more chance for it to fail” (Christchurch City Council,

1997c, p. 1). This move to establish objectives prior to design and implementation is essential when cultivating the ideal environment for a successful pay for performance plan (McAdams and Hawk, 1993; Wallace⁴⁶). Prior research has found that neglecting to specify objectives may contribute to a plan's failure (Wallace⁴⁷).

Finally, meeting two was used to identify the members' "*worst fears about performance bonuses*" (Christchurch City Council, 1997k, p. 1)⁴⁸. An awareness of the negative aspects of introducing a pay for performance plan is essential to ensure well reasoned and informed decisions (Young, 1990). The steep learning curve provided by the meeting with the Human Resources facilitator, meant members quickly became aware of a number of issues related to developing a pay for performance system. These were:

- i) "the principles of the system
- ii) how the system integrates with other rewards
- iii) the practicalities of how to develop a system" (Christchurch City Council, 1997k).

The remuneration team now felt there was a need for a "*total reward strategy*". This decision was not unexpected, for all elements of a compensation system should work together (Young, 1990). Further, having a reward strategy and linking it to organisational strategy will positively influence performance (Milkovich, 1988).

The three-legged diagram originally put forward as a potential model did not necessarily have to form part of the remuneration strategy. The team was encouraged to put aside any preconceived notions they may have of the ideal basis for pay for performance. Members were told:

"the danger is if you focus on [the three-legged diagram], you may limit your thinking of how to develop bonus payments, or you may overlook things that should be considered to give you an integrated strategy".

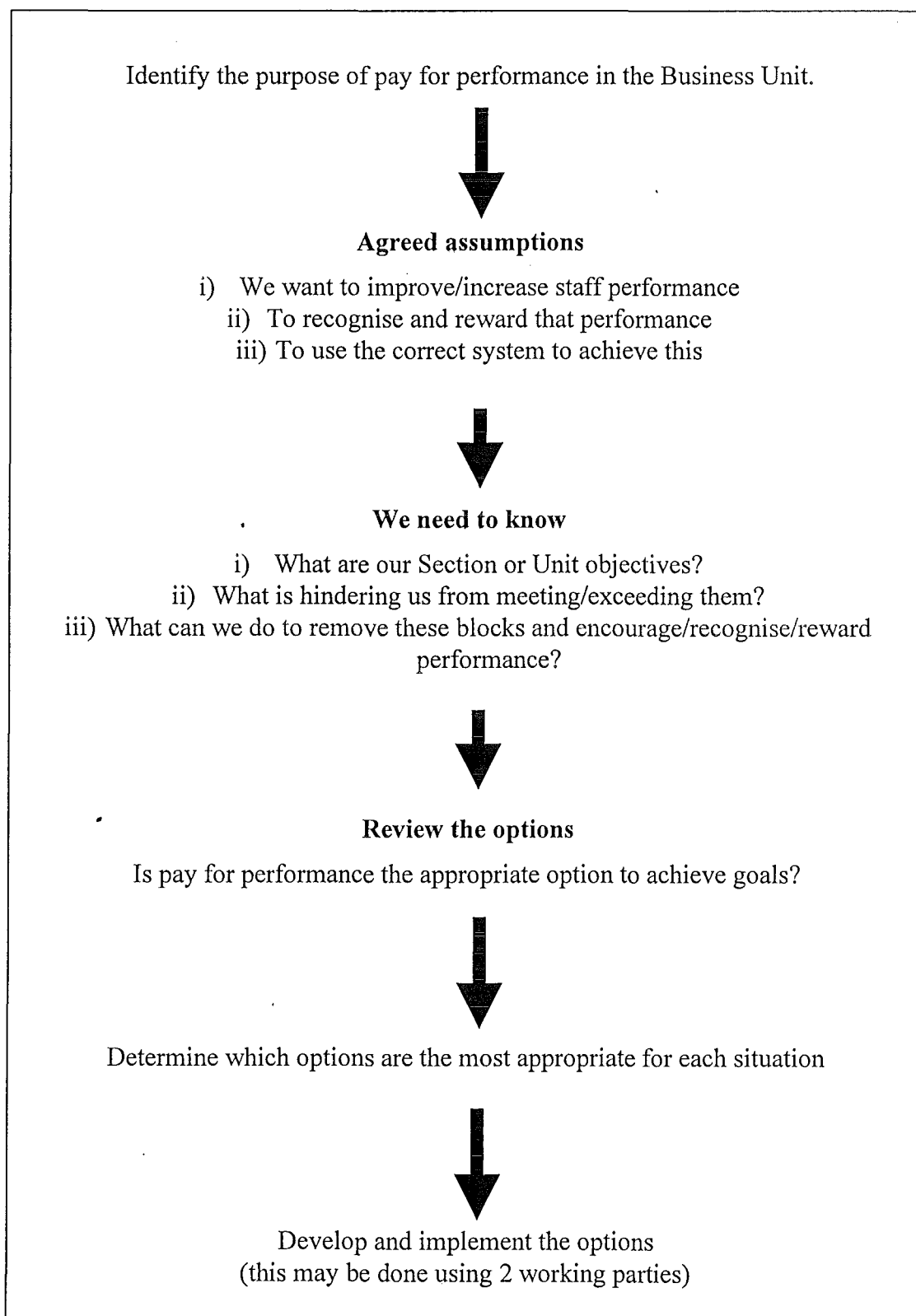
Following the meeting, the Human Resource facilitator provided the Unit Manager with an outline of the direction for the next series of meetings. This outline was agreed upon at the next meeting and a process diagram for this was developed

⁴⁶ Cited in Perry (1988), not referenced.

⁴⁷ Ibid.

(Figure 5-3, page 71).

Figure 5-3 - Business Unit A Remuneration Team Process Diagram
(adapted from Christchurch City Council, 1997b and 1997d)



⁴⁸ The disadvantages will be discussed later in this Chapter.

The remuneration team was now much more aware of what was involved in implementing a pay for performance system. It was agreed the Unit needed to:

“work through fears...cynicism and [the] integration of [a] variety of systems before developing “the system” ” (Christchurch City Council, 1997c, p. 2).

The third meeting was principally held to determine the objectives for developing a pay for performance system for Business Unit A. It was resolved that the Unit’s objectives were to:

- i) achieve agreement on explicit output results;
- ii) develop potential of employees;
- iii) lift performance by recognising, recording and rewarding “the extra effort, initiative, innovation and creativity”;
- iv) achieve performance “improvements for the Unit”; and
- v) improve job satisfaction and motivation (Christchurch City Council, 1997d, p. 1).

However, the Unit did not refer to the purpose of aligning their compensation to the organisation’s cost structure (Giblin and Kelley, 1994) and recruiting employees to fit the organisation’s culture (Lederer and Weinberg, 1996; Mandt, 1984). This result was unexpected as the financial aspects of pay for performance are often the most compelling (Giblin and Kelley, 1994).

The objective to achieve agreement on output results was unusual. Based on the proposed system at the inception of the design process, outputs were to form the basis of an individual’s goals. Pay for performance would not solve the problems with goal setting, rather it is reliant on clarity in this area (Liccione, 1997). Perhaps the intention for this objective was to prompt more work in the performance management area before pay for performance was introduced.

The third meeting also briefly covered different forms of pay for performance. This was to give members some background to other systems available, and introduce a different perspective to that which had already been presented (Figure 5-2, page 69).

Having identified the Unit objectives, meeting four was used to identify blocks to meeting or exceeding Unit objectives. Members were encouraged to identify

methods of removing these blocks. Once the blocks were identified, the ideas were grouped into two logical categories: internal factors and external factors. Specific problems were identified within each of the barrier headings that would, if solved, lead to the CCC being able to meet its objectives more easily. The internal factor category was further broken down into the following sub-categories:

- i) "Resources
- ii) Attitude
- iii) Policy and procedures
- iv) Skill levels
- v) Miscellaneous" (Christchurch City Council, 1997e, p. 1).

Examination of factors internal and external to the organisation provides an opportunity to determine potential barriers to implementing an equitable and effective pay for performance system (Dulling, 1996). Taking into consideration these factors will enable an organisation to determine the readiness of their organisation for a pay for performance system (Gross and Bacher, 1993). Furthermore, it may become evident that pay for performance is not appropriate for sections of the workforce (Clayman, 1998) or the entire organisation (Lawler, 1981).

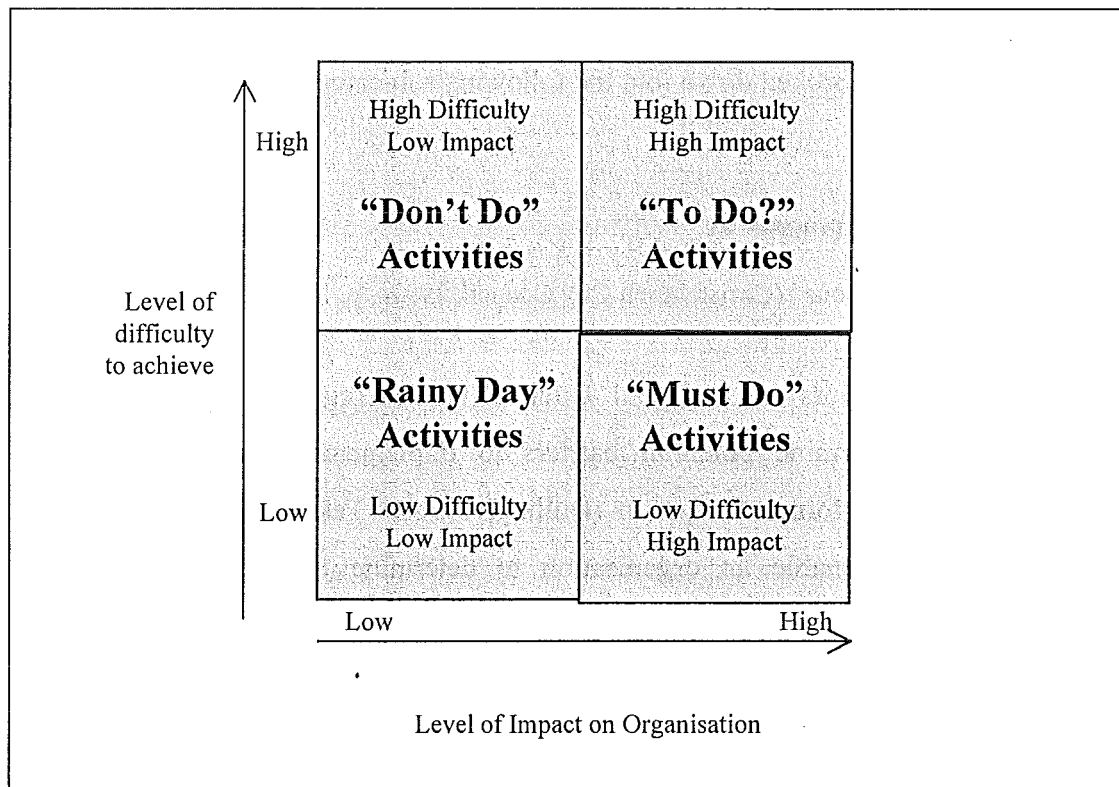
Meeting five focussed on sorting these blocks to achieving organisational objectives into the Prioritisation Matrix (Figure 5-4, page 74). This matrix:

"enables you to decide on what order to tackle the items as well as whether an item should be dealt with at all".

As a result of this prioritisation, four issues, or opportunities, regarding the current system were identified at the sixth meeting. Once these issues were identified, members of the team were assigned tasks in order to find ways to reduce the gap between the current system, and the system the team believed was the most appropriate. These tasks fell into the "must do" category of activities, and involved working on:

- i) Better recruitment;
- ii) Training to address non-performance;
- iii) Coaching for high performance; and
- iv) Creation of a better customer focus.

Figure 5-4 - The Prioritisation Matrix
(Christchurch City Council, 1997a, p. 4-17)



Addressing these issues before implementing a system was essential in order to design the ultimate system. Meeting seven was used to determine the gap between where the Unit was and where they wanted to be, along with possible solutions. Four key issues for the staff and CCC were identified:

- i) An employee’s remuneration does not vary with performance;
- ii) There is a lack of clarity on what the merit steps are based on;
- iii) The system depends on the effort made by managers and supervisors; and
- iv) Managers and supervisors do not understand how to apply the system consistently (Christchurch City Council, 1997f).

Long term action was to focus on whether “the system needs to change?” (Christchurch City Council, 1997f, p. 3). If so, what was the system to achieve and how much change was appropriate?

Remuneration members resolved that interim action should:

- i) address the four issues identified during meeting six;
 - pay was not based on performance.
 - there was a lack of clarity on how merit steps were earned.
 - the system was dependent on the effort made by managers.
 - Managers did not know how to apply the system consistently.
- ii) improve the criteria for merit steps and tie this to Personal Value Plans;
- iii) communicate the system to raise understanding.

Each member of the remuneration team was responsible for researching solutions to the four issues identified by the team. Three members of the remuneration team were given the task of focussing on a sub-set of performance management. Their assignment was to concentrate on rewards and reward strategies, in particular, to develop a link between Personal Value Plans and pay.

3.1.1. Linking Personal Value Plan and Remuneration

Two meetings were held to determine how to link the Personal Value Plan and remuneration. Prior to the first meeting each member considered how to adapt the Unit's remuneration system. At the first meeting, one member presented a diagram depicting the current review system (Figure 5-5, page 76) and a proposed system that he had drafted (Figure 5-6, page 76).

Within the current system, targets and competencies were reviewed every six months at Personal Value Plan meetings and did not directly affect the remuneration of an employee. However, it was noted that *"performance against targets could indirectly affect an employee meeting their merit step criteria"*.

The proposed review format was to be based on the achievement of outputs. The outputs were to be aligned with the CCC Business Plan, Unit Value Plan and Team Value Plan. Taking this approach to setting goals in a pay for performance system is recommended as a method to ensure goal congruence (Dyment, 1987; Kinnie and Lowe, 1990; Meehan, 1992; Minken, 1987; Romanoff, 1989; Sink and Sahl, 1995). Three types of outputs were suggested:

- i) Core outputs were the *"things you are supposed to do, the key functions of your role"*. Core outputs would be taken from your job description and

would encompass the provision of service activities. 5-6 core outputs were recommended.

Figure 5-5 - Current Review Format

(Christchurch City Council, 1997g, p. 1)

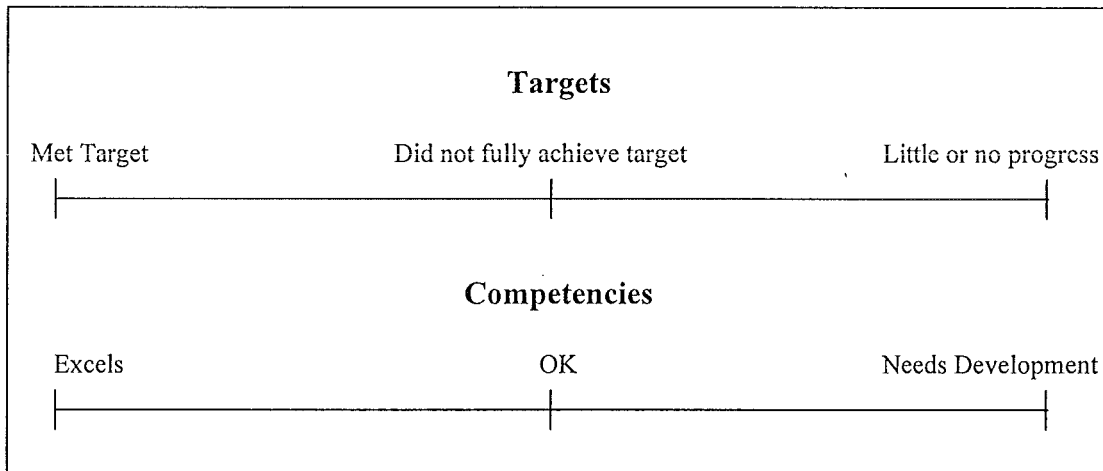
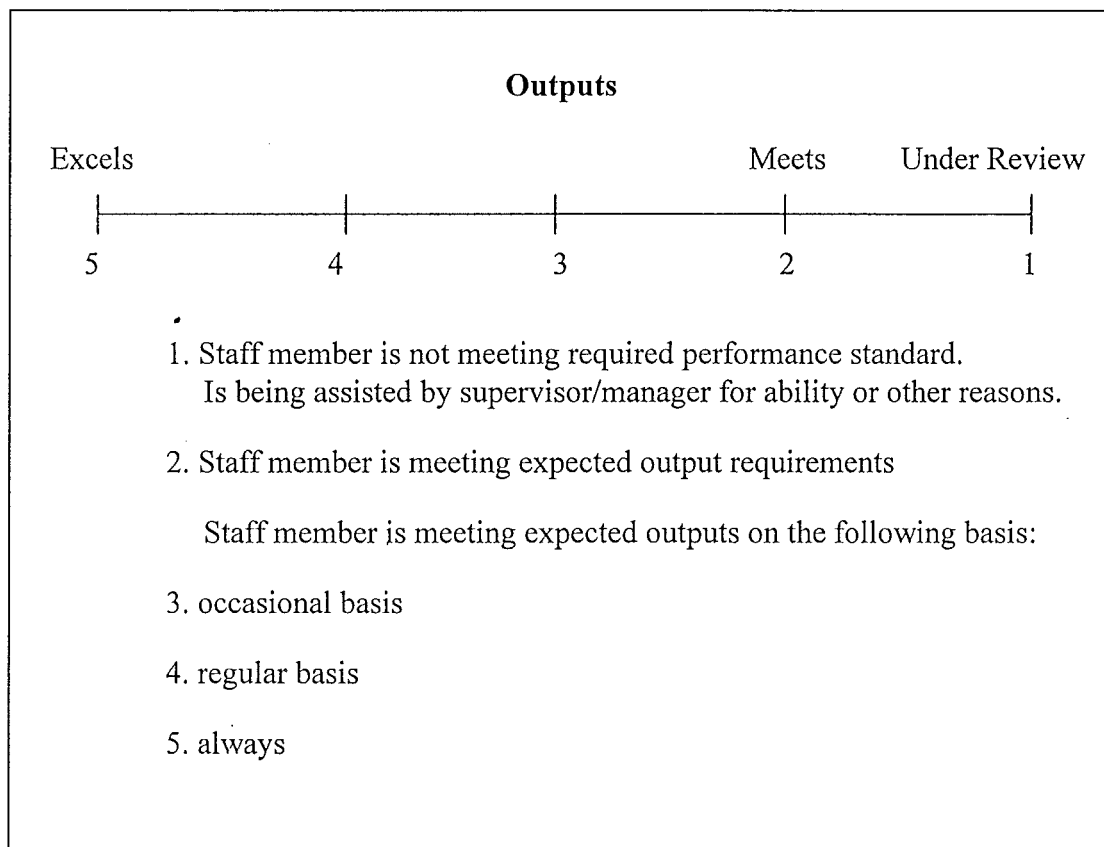


Figure 5-6 - Proposed Review Format

(Christchurch City Council, 1997g, p. 1)



- ii) Improvement outputs included “personal and other improvement areas required to improve overall performance” (Christchurch City Council,

1997g, p. 1). These relate to “continuous improvement and Human Resource issues” (Christchurch City Council, 1996/97, p. 5). 2-3 improvement outputs were recommended.

- iii) Project outputs were “new initiatives and improvements required to give improvement in the core output area. They also [included] one off projects for the “Overall Good” ” (Christchurch City Council, 1997g, p. 1). Attendance on teams, such as the remuneration team, may be a project output. 2-3 project outputs were recommended.

Approximately 21 competencies were recommended. These included aspects of individual’s personality such as integrity, innovation and commitment. Competencies were considered:

“essential for use in determining, obtaining and rating core and project outputs. All competencies [were] included within the core and project output areas and [were] necessary for these outputs to be met for merit consideration” (Christchurch City Council, 1997g, p. 1).

The nine to twelve outputs and 21 competencies included in the proposed review would vary from position to position. An employee would be rated on individual outputs or competencies according to the proposed format (Figure 5-6, page 76). Each rating category⁴⁹ is assigned a percentage weighting and this would be used to determine the final rating for an employee. There should not be too many outputs, or objectives, for employees or they will be unsure of an organisation’s priorities (Macaulay and Cook, 1994). As the outputs of the proposed system were split into categories, it would be easier for an employee to determine priorities.

The competencies were to be used as one measure of an employee’s performance. Romanoff (1989) believes the use of personality traits as a measure of performance assumes that the traits are synonymous with success and are able to be changed easily, whereas this is not the case. They are, therefore, not a good measure of performance. The subjective nature of these types of measures are often an issue with unions and employees (Lowery et al., 1996).

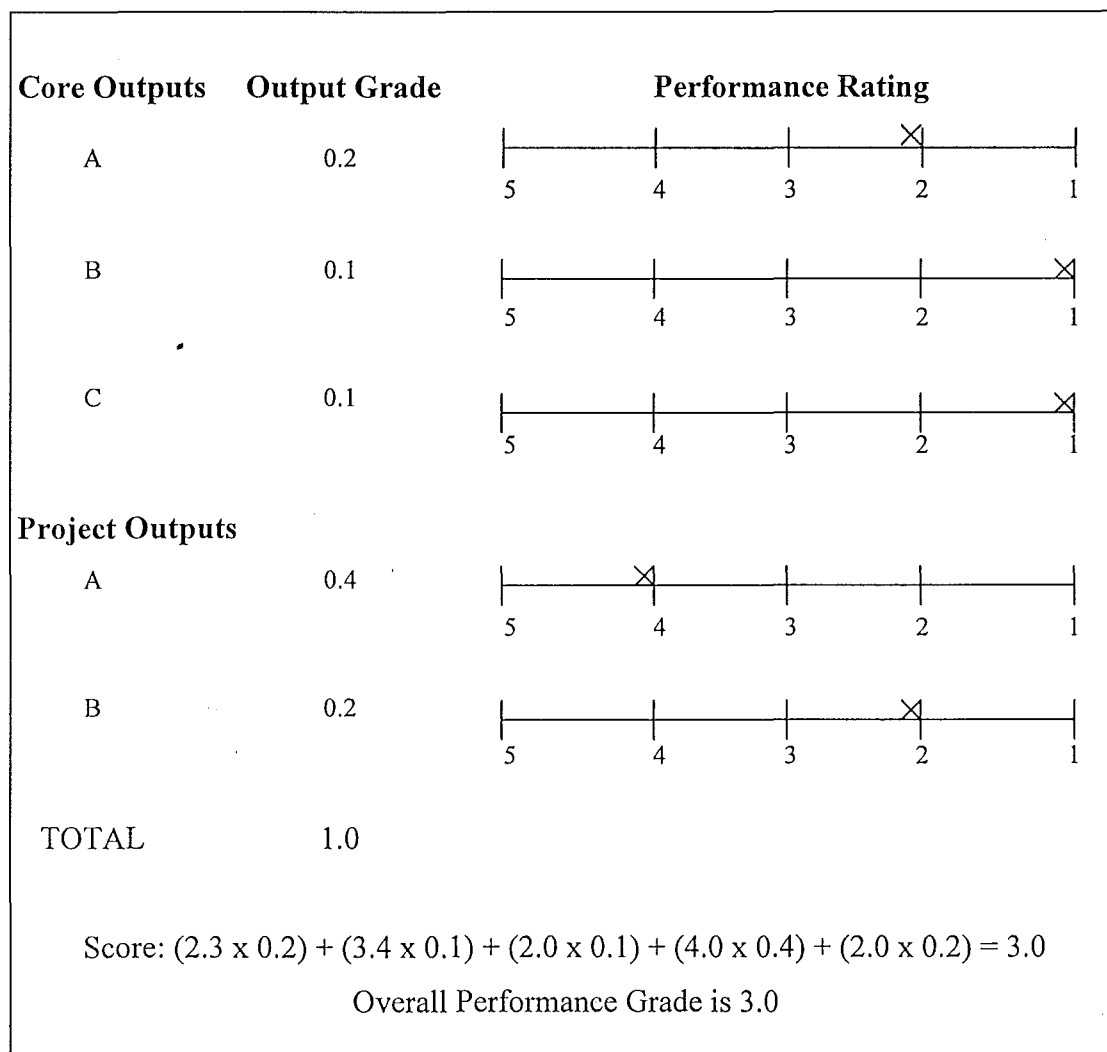
The proposed system was discussed and modified until consensus was reached by the

⁴⁹ A category may be an output (core, improvement or project) or a competency.

three members responsible for this project (Figure 5-7, page 78). The main difference to the second proposal was *each output* was weighted to indicate the importance of that item. The total of the grades was to equal 1.0. The final performance rating would “determine the level of merit entitlement” (Christchurch City Council, 1997h, p. 1).

The weighting of objectives is an excellent way to ensure that the organisation’s priorities are understood by employees (Geske, 1989, Sink and Sahl, 1995). The use of the term ‘entitlement’ when referring to the level of performance payment is unusual, particularly when the team was striving to design a system that would *not* be seen as an entitlement, but rather a payment that was dependant on performance. When a performance payment is viewed as an entitlement the link between pay and performance is not reinforced (Meehan, 1992).

Figure 5-7 - Proposed Link to Merit Increase - An Example
(Christchurch City Council, 1997h, p. 2)



The consensus by the three project members, on the proposed system, was subject to adequate clarification on a number of issues:

- i) Should the merit increase apply only to base salary (ie 100%)? If not, the staff at 110% would receive a higher bonus whether it was deserved or not.
- ii) Should the merit increase be applied as a percentage of salary or a lump sum⁵⁰ per employee?
- iii) Who would control the system? It was felt that this would be at the discretion of the Section Manager. It was noted “a well controlled and operated system should give a normal distribution of staff between 2 and 5 on the performance rating scale” (Christchurch City Council, 1997h, p 1).
- iv) Should the system be initially trialed without a link to remuneration? Members recognised that the Unit could “use the continuous improvement approach of graphing the distribution of performance scores so staff [could] see where they fit”. It was further noted that “this should give time to improve any problems before it hurts” (Christchurch City Council, 1997h, p. 2).
- v) The initial set-up and subsequent ranking of the outputs was vital to “the performance of the system”. It was recognised that investment in terms of time and effort was required to ensure a system that promoted goal congruence throughout the Unit (Christchurch City Council, 1997h, p. 2).
- vi) It was anticipated that the development scale of 90 - 100 %, within the Salaried Staff Collective Contract, would fit onto this rating system and allow for assessment. How this was to occur was not specified.

These issues raised by the members of the project team, reflect an awareness of many important aspects of designing a pay for performance system. This was evidenced by the suggestion that the new system initially run without a link to pay. This would increase the employees’ understanding and acceptance of the system and enable

⁵⁰ A lump sum payment is given to employees in lieu of an increase in salary (Harris, 1996). This does not become part of base salary (Perry, 1988).

problems to be identified. Ensuring the system runs smoothly before it is linked to remuneration is a strategy recommended when developing the most equitable system (Flannery et al., 1996). This will also allow time to nurture the culture necessary for the plan to achieve its objectives (Flannery et al., 1996).

The major problem members were presented with when designing a new system was the existing salary structure. Employees throughout the organisation could be at different levels on the salary scale (90-110% for those staff under the Salaried Collective Contract). This may be due to the length of employment rather than the performance of the employee in their role. A change to salary structures would entail lengthy negotiations with union representatives from five different unions. The magnitude of this change meant that this option was not seriously considered by the remuneration team.

Utilising a forced distribution system⁵¹ was another option under consideration. When determining the most suitable form of reward for the Business Unit, a few options were considered. The 'cafeteria' plans⁵² noted in Chapter 2 were identified as an option, along with merit increases from 100% to 110% and a lump sum bonus for employees. Intrinsic rewards were already utilised within the CCC. 'Bouquets' were given to employees that had made a difference within the organisation. The bouquet may be, for example, movie tickets, dinner vouchers or flowers.

At this point in the design process, the members of this project team resolved to take the second proposal (as noted in Figure 5-7, page 78), with the accompanying issues, to the remuneration team for discussion and agreement before any further developments were made. Business Unit A reached this point in the design of their pay for performance system in November 1997. In late November a meeting was scheduled to determine how Personal Value Plans may need to be changed, to decide how the system was to work and to discuss progress made by the three team members responsible for developing a link between Personal Value Plan and remuneration (Christchurch City Council, 1997i).

⁵¹ A forced distribution system restricts "the percentage of employees who can be assigned a rating" (Meehan, 1992, p. 48).

⁵² A cafeteria system allows employees to choose from a 'menu' of benefits (Hodge, 1998).

During this process of design, a number of advantages and disadvantages were identified. These factors concerned both pay for performance in general and the process undertaken by Business Unit A.

3.2. Advantages of the Design Process

Responses from members of the remuneration team when defining pay for performance demonstrated an appreciation of the advantages of pay for performance systems and the process followed by Business Unit A. Members believed a pay for performance system would prompt favourable consequences in a number of areas.

Remuneration team members recognised that a pay for performance system could prompt employees to focus on the CCC's goals (Christchurch City Council, 1997c). The strategic objectives would be brought to the attention of those who had the ability to influence its success (Geske, 1989; Laabs, 1996; Pederson and Lidgerding, 1995).

It was noted that a pay for performance system would save the CCC money. Conversely employees would have the opportunity to earn more. Flexibility in compensation costs is often considered an advantage of introducing a pay for performance system (Gandossy and Scheffel, 1995; Rich and Florin-Thuma, 1990; Turner, 1996). However, members of the remuneration team did not mention that the CCC's compensation costs could also increase when the performance improved.

Respondents believed the introduction of a pay for performance system would improve organisation and individual performance. Employees who were "coasting"⁵³ would now have to work harder, thus removing several inequities currently found in the system (Christchurch City Council, 1997c, p. 3). Employees not performing would be identified and dealt with appropriately. The cultural change that often accompanies the introduction of a pay for performance system contributes to the improvement of performance (Ross, 1988).

There was a strong focus on how a new system would affect employees. Members believed the addition of pay for performance would provide employees with an

⁵³ "Coasting" refers to employees that expend minimal effort when performing their duties.

incentive to remain with the CCC. Furthermore, employees would be more motivated and satisfied with their jobs. Increased employee retention is often viewed as an advantage of introducing a pay for performance system (Banker et al., 1996; Geske, 1989; McGinty and Hanke, 1989; Ross, 1988).

The main advantages outlined in Chapter 2 were identified by members of the remuneration team, reflecting an awareness of what an ideal pay for performance system could achieve. When asked to describe the advantages of Business Unit A's design process, additional advantages were identified. The devolution of authority to the individual Business Units was singled out as having particular value:

"The Council covers a wide range of industries (eg roading, rubbish collection, promotions and marketing, parks, technical services). Because of this there are many different needs within the Council. Looking at what suits each Unit acknowledges this difference";

"It recognises that Units may be at different stages of development and may wish to change at different paces";

"It enables the Units to work through the issues as they are ready to face them".

It is recognised that different positions within an organisation should have objectives and measures customised to suit their unique nature (Cumming, 1988). Furthermore, different sections within an organisation may be at varying stages of "cultural readiness" for pay for performance (Gross and Bacher, 1993, p. 53). The readiness of a Unit for a new compensation system is a determining factor in its eventual success (Gross and Bacher, 1993). Decentralising compensation decisions is a new process that is compatible with the move towards flatter organisational structures (Smith, 1992). A corporate-wide system would not provide the same benefits to the Business Unit and would work against the culture that was being cultivated within the organisation. As one interviewee noted:

"Units believe that they know their own business best. If a corporate system was determined and given to all workers, it would undermine the culture that has been built up".

Members of the remuneration team believed designing a plan at Unit level would increase the level of commitment and acceptance of a plan:

"It gives flexibility to the Business Units and empowers them;

"There is more commitment to a system initiated at Unit level rather than at corporate level".

Involving employees in the design of a new compensation increases the acceptance and understanding of the plan (Cumming, 1988). Furthermore, employees take ownership of the system when they have been involved in the design. Involving employees in the design of Business Unit A's design meant:

"Units were encouraged to take ownership of their problems, and they form a culture of leadership. Taking ownership of the process means ownership of the successes and failures";

"People are encouraged to challenge poor performance, and feedback is encouraged at all levels";

"If it is done properly then it will be a good thing. It will lift morale and get people to perform better. But it is part of a package, if they are rewarded better, and are still treated badly, then the benefits will not be forthcoming".

However, when questioned as to the advantages of Business Unit A's approach to designing its pay for performance system, the response from one interviewee was "none". In clarifying this response, the interviewee noted a number of disadvantages. These disadvantages, along with other responses, are included in the next section.

3.3. Disadvantages of the Design Process

Disadvantages that were expressed related to pay for performance in general and Business Unit A's approach. There was an awareness that pay for performance on its own would not work, it had to be coupled with sound management and goal setting (Giblin and Kelley, 1994). However, members of the remuneration team did question whether pay for performance was necessary:

"If goals are clearly defined then you don't need to worry about pay for performance";

"If you have performance management that is objective then that is ideal. It all comes down to management technique and style. If you can manage well then you can convince people that what they are doing is worthwhile [without pay for performance]".

"Is it worth the effort?" (Christchurch City Council, 1997c, p. 4).

"For the already performing, is it a farce?" (Christchurch City Council, 1997c, p. 4).

There was a concern that the move towards pay for performance was merely a method of reducing wage costs, that people were going to “lose money” (Christchurch City Council, 1997c, p. 4):

“If the drive is for dollars, then this usually means that you get rid of people, as wages is generally the only variable cost that the manager can really influence. This usually happens before new systems are in place, and it puts more stress on the existing people. It is a vicious circle”.

Behavioural consequences to the pay for performance system were of concern to members of the remuneration team. The system could “promote tall poppy behaviour [and] divide a team” (Christchurch City Council, 1997c, p. 4). Jealousy between employees would increase and people would guard their ideas rather than share them with their Section (Christchurch City Council, 1997c). Further, what would the “impact [be] on self-esteem if no bonus [was] received?” (Christchurch City Council, 1997c, p. 1).

These concerns are also reflected in the literature. When pay for performance systems are introduced teamwork is diminished as employees are working against each other rather than together towards common goals (Deming, 1986; Kohn, 1993; Parnell, 1991).

Many concerns with pay for performance systems stem from the performance management process: goal setting, performance measurement and performance appraisal (Brough, 1994; Deming, 1986; Meehan, 1992). Remuneration team members were also concerned with goal setting. Would the most appropriate objectives be set? “Are we paying people for something they should be doing?” (Christchurch City Council, 1997c, p. 4).

Performance measurement is a particular problem within the public sector, for there is no profit motive to benchmark performance (Wisdom and Patzig, 1987). Furthermore, many public sector organisations operate in the service sector where choosing meaningful performance measures poses a particular challenge (Wisdom and Patzig, 1987):

“When you have pay for performance, if the manager assessing you is not working “on the job” you can’t see the real performance, and it has to be measured subjectively”.

“How [do you] measure people in [a] backroom job?” (Christchurch City Council, 1997c, p. 4).

“How do you value cost reduction?” (Christchurch City Council, 1997c, p. 4).

Interviewees also expressed concerns regarding the performance appraisal process, in particular the manager’s lack of objectivity when appraising employees:

“There could be potential personality clashes between the person that sets targets and the person who must achieve them”.

“[Managers will be] too scared to say “no you don’t get it” ” (Christchurch City Council, 1997c, p. 4).

The connection between pay and performance is often damaged by managers (Lawler, 1981). Objectivity and consistency do not exist when a manager is evaluating their employees, bias is inevitable (Wilkerson, 1995).

It is important to target those that can influence an organisation’s performance, or the scheme may become too expensive to sustain (Anonymous, 1988). However, including all employees in a pay for performance plan may be a strategic objective, for instance, to promote cultural change. Only one interviewee mentioned any concern about implementing a system for all staff within Business Unit A. This employee felt:

“one system for all staff within the Unit will be difficult. Staff includes top management to farm labourers. It would be hard to set targets that are genuine enough for farm labourers”.

Furthermore, companies that are committed to business unit autonomy would benefit from decentralising compensation decisions (Smith, 1992).

There was no mention of any negative union reaction to the move to pay for performance. Conversely the reaction from the Amalgamated Workers Union⁵⁴ had been positive. Although this was *“probably because [the remuneration team was] looking more at bonus schemes rather than the substitution of base pay rates”*. Generally when pay is related to performance, the unions are unable to influence wage increases, as they are based on performance (Proctor et al., 1993). However,

⁵⁴ The Amalgamated Workers Union is a bargaining agent for the Outside Staff Collective Employment Contract.

the system proposed by Business Unit A did not place the base salary at risk. Employees would either earn an incentive on top of their salary, or their income would remain the same. For this reason, it is not surprising that the unions did not object to the proposed system.

A union was approached to join a working party to design another Business Unit's pay for performance system. The union did not want to join the process as they were:

"concerned that their involvement could compromise the workers' interests. However it was explained that even if they got to the end of the design process and they were not happy with the system then it did not mean that they had to accept it".

Acceptance of a pay for performance plan by the Unions was viewed as imperative. A major objection of unions, is once a pay for performance system is introduced they can be isolated or removed from pay negotiations (O'Connor, 1994). The CCC was not looking to remove the unions from the pay process, and recognised:

"if the union was not happy with the design then it would not have achieved the objective of the pay for performance system anyway".

Disadvantages with Business Unit A's approach to design also involved concerns about the equitability of the scheme and the process that was followed. Initially there was some confusion about what was involved in designing a system:

"The whole process was not explained from the start, and what was involved changed significantly when [the human resources representative] came along".

While there were a number of advantages of having each Business Unit designing their own remuneration system, interviewees also mentioned the following disadvantages:

"There is some question as to the long term equitability of the schemes. [Employees] want a common link between the Units";

"There is the potential for fragmentation and the long term costs are not known";

"Is anything being implemented at all? If the Units can go at their own pace there is the facility for nothing to occur";

"This [part of the Unit] does not have its goals well defined, and unless that is defined it is hard to define anything else".

Should managers within the Business Units of the CCC not have clear responsibility for the expenses in their Unit, then the more traditional approach to remuneration would be more appropriate (Smith, 1992). Empowering Business Units in the area of remuneration is an area where there has been little guidance in the literature. It represents an approach that moves the human resource functions back its traditional support role (Smith, 1992). Further research into delegation of remuneration decisions to Business Units is needed.

There was also some concern regarding the direction of the design process:

"People in the teams want more direction and perhaps some corporate guidelines".

The amount of time the remuneration meetings took was an issue with team members. Responses were mixed on this point, as some respondents believed this was necessary in order to properly consider the relevant issues:

"It wastes time";

"It is time consuming, and we have not yet reached a conclusion that can be put in place, and are a long way off a financial reward system";

"It is going a little slowly, but it is not something that you should rush into";

"It is taking quite a bit of time, but it is worthwhile. If it is not done properly then it could have an adverse effect".

Other comments centered around administrative problems:

"There has not been regular attendance at the meetings which creates continuity problems";

"The meeting rooms are awkward, too small for the number of people";

"We don't get the minutes/results/summaries of the meeting until the next meeting";

"We go in cold to meetings. As it is an important issue, if I was able to prepare for the meetings, I could then provide better responses".

The disadvantages and advantages identified by remuneration team members, influenced the decisions made when designing the pay for performance system. In order to investigate the full design process undertaken by Business Unit A, a second phase of research was conducted.

3.4. One Year Later...

In October 1998 the site was revisited. The objective of this phase of the research was to ascertain the Business Unit's progress following the last contact by the researcher. When asked of the developments made by the Business Unit in designing and implementing their pay for performance system, the response was:

"Nothing, absolutely nothing!";

"Nothing has really happened since we last spoke with you";

"It just died".

The meeting scheduled for the end of November 1997:

"just never happened. It was put off until after Christmas, and 'after Christmas' never arrived".

There were a number of reasons posited for the lack of advancement. Firstly, there was recognition that the Business Unit was not ready to implement pay for performance for individual employees. There needed to be changes to the existing salary structure:

"It was difficult to go forward with the pay system that we have at the moment. There needs to be changes to the salary structure first";

"I think we realised that there is significant work required, and that further development was critical".

Personal Value Planning needed to be reworked before it could be successfully linked to remuneration.

There was also recognition of the difficulties involved in selecting appropriate performance measures:

"We need to go back a step and look at Personal Value Plans. If they are not right, then the system will be fraught with measurement problems and inequities";

"There needed to be more work on the Personal Value Plans, there was a lack of tangible, robust measures. The language was too airy fairy and the measures were therefore difficult to quantify".

As noted in Chapter 2, major criticisms stem from problems with performance measurement and goal setting. Performance measures in the public sector pose particular problems due to the lack of profit motive and the inherent difficulties

determining performance measures for service organisations (Wisdom and Patzig, 1987).

Secondly, it was posited the process may have stalled due to external pressures and uncertainty faced by the Business Unit:

"The rate of change over the last year has increased, Units are facing a lot of external pressures...the Unit probably wants to see how the changes will affect them. Until then the Unit won't want to rock the boat".

It was possible that several Units within the CCC could be turned into Local Authority Trading Enterprises (LATEs). If this was to happen then the Units would become new organisations and would, therefore, employ staff on new contracts. In an unstable environment the redesign of compensation systems will not be a high priority for management (Applebaum and Shapiro, 1991). This supports the assertion that organisations place different priorities on compensation decisions when they are at different stages of their lifecycle (Stewart, 1993). Further internal and external factors must work together to create a suitable environment for pay for performance to work equitably (Dulling, 1996).

A third explanation was provided by two respondents who believed the development of a new system had been *"put into the too hard basket"*. Further, it was suggested *"the Unit Manager lost interest"*. This statement provides indirect support for the argument that a zealot driving a pay for performance system will strongly influence its eventual success (Gandossy and Scheffel, 1995). In this situation the lack of strong leadership has meant development of a new system has stalled.

Finally, it was suggested there *"were mutterings about reward and recognition on a Corporate basis"*. Upon further investigation it was found there was not going to be a corporate led reward and recognition strategy. However, it was recognised the CCC needed to *"look at the remuneration processes that can be altered and transferred to suit other Units"*. The CCC wanted to provide the correct environment for pay for performance, but did not want to stipulate the remuneration system for each Unit, as this would be an unpopular move. As one interviewee noted, *"corporate edicts go down fairly flat"*.

The CCC decided to *"provide the framework for performance management through*

updating job descriptions, Job Value Statements and addressing poor performance". In mid 1998, the CCC commenced a three module training programme. Each module was targeted at improving performance management in the organisation. The modules were:

- i) Job Value Statements;
- ii) Performance Value Planning; and
- iii) Dealing with poor performance.

In line with the corporate philosophy, Units were able to address the Job Value Statements and Performance Value Plans at their own pace:

"The changes to the Personal Value Plans and Job Value Statements were not a corporate edict. Each Unit is able to move through the statements and make changes as they are ready. The changes have been incremental";

"The reason for this is that the Units are at different states of readiness, and are facing different environments".

This statement provides support for the argument that the "cultural readiness" of a Unit or organisation is an important consideration when designing a pay for performance plan (Gross and Bacher, 1993, p. 53). It was further noted:

"The approach to reward and recognition will be, where possible, similar (although this will be subject to the collective contract)".

In October 1998, a member of the Human Resources Department met with a Remuneration Consultant. It was envisioned that this consultant would, in conjunction with a Human Resources representative, be an aid to the Business Units. The consultant could *"drive the process"*.

At the completion of this research Business Unit A had not completed the design of their pay for performance system. This in itself did not necessarily mean that the team had failed in its objective to design an appropriate system. However, as there was no formal conclusion to the design process it is difficult to say that with certainty. It is possible that the design process stalled because of a recognition that the environment faced by the Unit did not support the introduction of a pay for performance plan at that time. However, if the process was hindered by the lack of drive and expertise this raises very different issues. A discussion of the process undertaken by the Unit in conjunction with the literature follows in the next section.

4. DISCUSSION

While members of the remuneration team in Business Unit A were not experts in the Human Resource field and had not completed the introduction of a new pay for performance system, they showed an awareness of many important issues within the literature. The comprehension of these issues was largely due to the influence of the Human Resources facilitator, who shaped the remuneration team's decision to widen the process from one of designing a pay for performance system, to designing and refining the performance management system. The procedure followed by Business Unit A supported the direction suggested in the literature, with a few interesting exceptions.

The nature of the pay for performance system preferred by Business Unit A, Personal Value Plan, meant the incentive plan would be unique for each employee. Custom-designing reward systems is necessary because a universal plan can not meet the needs of all sectors of an organisation (Applebaum and Shapiro, 1991), nor can it suit all positions within an organisation (Cumming, 1988). However, allowing Business Units to design their own remuneration systems is a very new phenomenon, that has not been widely reported in the literature. The implications of taking this approach was explored. This topic warrants further investigation.

Public sector organisations are often faced with many changes occurring simultaneously within their organisation, and the CCC is no exception (Brough, 1994). The nature of public sector organisations has meant that they generally have more work to do, than private sector organisations, to become responsive to their environment (Brough, 1994). Organisations are advised to integrate their change in compensation with other change initiatives and to develop a comprehensive change strategy (Bunyan and McGill, 1997; Flannery et al., 1996). Business Unit A's individual approach to remuneration was supported by initiatives such as Job Value Statements, Personal Value Plans and the training modules commenced by the CCC in 1998. Performance management also featured strongly within the CCC. Although Job Value Statements and Personal Value Plans were relatively new concepts within the organisation, they seem to have been embraced by Business Unit A. Members recognised the crucial role of goals and performance measurement within these plans.

The outputs of the Business Unit were the foundation of the proposed compensation plan. However, determining the appropriate outputs for Business Unit A and their employees was outside the scope of the design process and was addressed at training sessions during 1998.

At the inception of the remuneration meetings, Business Unit A agreed on a process diagram to drive the development of their pay for performance system. The first step was to decide on the objectives of the Business Unit. Following this, barriers to achieving those objectives were identified. These barriers were divided into two categories: internal and external factors. Identification of these factors enables an organisation to ascertain the changes necessary to ensure the maximum effectiveness of a new remuneration system (Dulling, 1996). Business Unit A took an alternative approach by identifying barriers to meeting Unit objectives. This resulted in the identification of pertinent internal and external factors.

One obstacle to the design process that was not initially acknowledged by members of the remuneration team, was the existing salary structure. Aside from the salary structure element to design, the remaining internal factors recognised by Business Unit A were more specific than those in the literature, and included issues predominantly related to performance management. The broader issues of culture and life cycle of the organisation were not addressed by the Business Unit. The specific issues identified by Business Unit A were tasks that the Business Unit was anticipating carrying out. It is unlikely that Business Unit A would endeavour to revamp the existing salary structure. This is a major problem to the Business Unit as the existing salary structure posed the greatest barrier to the design of a new system.

Following identification of these barriers, Business Unit A decided on the objectives for their new remuneration system. When objectives are agreed prior to design, organisations are able to structure the design of their system to make it more likely that their objectives are achieved (McAdams and Hawk, 1993). Business Unit A's objectives for developing a pay for performance system were consistent with those listed in Chapter 2. However, the Unit did not refer to the purpose of aligning their compensation to the organisation's cost structure (Giblin and Kelley, 1994) and recruiting employees to fit the organisation's culture (Lederer and Weinberg, 1996;

Mandt, 1984). This result was unexpected as the financial aspects of pay for performance are often the most compelling in this competitive environment (Giblin and Kelley, 1994). The objective to achieve agreement on output results was unusual. Pay for performance would not solve the problems with goal setting and performance measurement, rather it is reliant on clarity in this area. Perhaps the intention was to prompt more work in the performance management area before pay for performance was introduced.

Having identified the objectives, the next step in the process was to determine the type of pay for performance system that would best suit Business Unit A. There was the possibility at this stage, that the Unit would decide that the barriers to performance should be reduced and the design process put on hold. Different types of pay for performance systems were introduced briefly to remuneration team members. However, members did not mention the consideration of any variations to the original blueprint for design. The Unit may have found upon further investigation that a different type of system would be more appropriate to the objectives and circumstances faced by the Unit.

The scheme proposed by Business Unit A did not stipulate the form a reward would take. Two options were seriously considered: provide an annual lump sum bonus; or a merit increase. Remuneration team members did not advise whether the option of a percentage bonus was considered. The culture in the CCC meant that intrinsic rewards, such as recognition, already played a part within the Business Unit.

The remuneration team had not stipulated a process to follow after the decision to start the design of a pay for performance system. Those members of the remuneration team responsible for developing the link between the Personal Value Plan and remuneration did not receive instruction in this area. There has been little or no guidance in the literature to aid in the development of formal process in this situation.

The decision to include all staff in the new pay for performance design was not made consciously by the remuneration team. Taking a strategic approach to implementing compensation systems was a suggestion from the corporate office. This contributed to all employees being involved in the pay for performance initiatives in Business

Unit A. Although each of the principle collective contracts were represented in Business Unit A, the design of the proposed system appeared to focus on the Salaried Staff Collective Contract. This is further evidence of the lack of guidance for members in the design phase of the process. As the system was intended to be applied to all staff within the Business Unit, the other collective contracts also needed to be integrated within the design.

An issue related to performance management is forced distribution. Business Unit A included an indirect reference to forced distribution in the proposed pay for performance system. However, members of the team did not mention any potential negative implications of such a move. Employing a forced distribution system may not support the objectives of implementing a new system. Yet, some organisations believe the forced distribution system is necessary in a pay for performance system (Smith et al., 1987).

A pay for performance system that is funded at low levels, may induce a forced distribution effect on the system (Applebaum and Shapiro, 1991). Managers are restricted by their incentive budget and may not be able to adequately reward all meritorious employees (Applebaum and Shapiro, 1991). As the form of reward had not been settled on at the conclusion of this research it was not known whether this would be an issue.

The critical nature of Personal Value Plans was illustrated by respondents comments linking the deficiencies of the plans to the suspension of the design process. The inherent characteristics of the public sector means that this result was not unexpected. Developing performance measures for public sector organisations is a difficult process that poses a notable challenge to those involved in the design process (Wisdom and Patzig, 1987). This is due to the absence of a profit motive and the difficulty in developing meaningful measures of performance for service activities (Wisdom and Patzig, 1987).

The challenges of performance appraisals were also addressed by the Business Unit. Members of the remuneration team expressed their fear that managers may not have the skills, nor the will to evaluate employees equitably. Managers needed to address non-performance within their Business Unit and this was not happening. This area

was recognised as a barrier to achieving Unit objectives and is a problem within the area of performance appraisals (Sahl, 1994b). In 1998 the CCC addressed these deficiencies in performance management by commencing three training modules. They were:

- i) Job Value Statements;
- ii) Performance Value Planning; and
- iii) Dealing with Poor Performance.

Training in these three areas is strongly advised in the literature (Meehan, 1992). Training was crucial to the success of Business Unit A's proposed system and this was reflected in the reasons why the process had stalled. The lack of training on dealing with poor performance was a critical barrier that had to be addressed before significant progress was made in the design phase.

Managers should also be trained in methods of evaluating employees and avoiding rating errors. While rating errors may be dealt with to some extent in the third training module, as many rating errors are unconscious rather than deliberate, a module that outlines the common errors and their negative effects also helps to reduce these mistakes (Brough, 1994; Meehan, 1992). Training in this area would be appropriate should a system utilising performance appraisals be introduced.

Leadership is a crucial point when designing a new remuneration system. In this situation, the leader for the process was the Human Resource facilitator. Management influence and support is also a critical point in the design and implementation of a new or revised system (Berger and Moyer, 1991; Morris, 1996; Kinnie and Lowe, 1990). Most often the management and leadership is provided by the same people (McAdams, 1995). This difference may have presented a problem within Business Unit A. The person who initially championed the new system had firm ideas about what was to be achieved, but was initially unaware of the process that must be followed to ensure the system was robust. One of the reasons posited for the lack of advancement in the process was lack of interest from this manager. The facilitator's role was not to drive the process, but rather provide guidance when requested. This was a difficult role as the facilitator was the only person with the in-depth knowledge of designing pay for performance systems. This provides indirect

support for the notion that management support and forceful leadership strongly influence the success of a pay for performance plan. At the end of October 1998, the CCC decided to make a Remuneration Consultant available to the Business Units during their design processes. In the future, this may help provide the leadership and expertise needed by the Business Units when designing their remuneration systems.

Business Unit A was aware of many of the advantages of developing and implementing a pay for performance system. The effect on an employees behaviour was noted as a major advantage to Business Unit A. Poor performance and outstanding performance would become apparent and would be able to be rewarded appropriately (Banker et al, 1996).

The ability to retain employees within the CCC was mentioned as an advantage. This is supported by Banker et al. (1996) who believe organisations with pay for performance system attract and retain talented employees. However, team members did not mention the additional effects of improving the quality of the employee mix (Parnell, 1991), reducing voluntary turnover (Lowery et al., 1995; Parnell, 1991), and decreasing absenteeism (Lowery et al., 1995; Parnell, 1991).

Respondents referred to the flexibility that schemes can bring to an organisation, particularly with regard to cost savings. It is interesting to note that members of the remuneration team did not mention that a pay for performance system could be expensive for the organisation. This may indicate that employees view pay for performance schemes as a method of reducing wage costs rather than motivating higher performance. Further research in this area would clarify this matter.

Business Unit A was mindful of the disadvantages that may affect their pay for performance system. The majority of these disadvantages revolved around the performance management aspects of the system. During 1998, training by the CCC addressed many of these, however further training would be necessary if the Unit decided to go further with the design and implementation of their proposed system. Further comments were regarding the process that was followed by the Business Unit. There was criticism of the initial confusion about the process they were to follow and related administrative matters. Should Business Unit A return to the design process these problems could be addressed.

There has been a strong emphasis on employee involvement and communication, however it will not be until further into the process that the benefits of this approach may become evident. Taking a consultative approach has meant that the design of the system may take longer to develop, but this was considered necessary by most members of the remuneration team. Throughout the design process followed by Business Unit A's there was a strong emphasis on consultation. All employees within the Unit were to be consulted once a proposed plan was in a workable form. If all employees of the Business Unit were advised of the design earlier than this, the employees would have been confused by the details. This confusion would have led to resistance by the employees that would have been difficult to overcome (Sahl, 1994a).

5. SUMMARY

Business Unit A followed a process similar to that suggested by the literature when designing their pay for performance system. There were a few interesting exceptions.

The Business Unit was responsible for designing their own remuneration system. There is a dearth of literature regarding the implications of using this approach. Further research into this area is needed.

The leadership and management roles need to be clarified within the CCC. At present, those who would normally drive the process (i.e. the managers) do not have the knowledge to lead the process.

The salary structure of the CCC presents the most difficult barrier to effective design. Business Unit A chose to ignore the salary structure when developing a new pay for performance system. A change was needed in this area, but it was viewed as too difficult to do.

The design process undertaken by Business Unit A stalled at the end of 1997. This was not a conscious decision made by members of the remuneration team, rather the process stalled when a meeting was postponed and never rescheduled. It was posited that the design process stalled because of:

- i) Difficulties with the existing salary structure;

- ii) Difficulties with performance measurement;
- iii) External pressures and uncertainties; and
- iv) Lack of support by management.

Deciding not to design and implement a system for a Unit or organisation does not automatically mean that process has failed. It may be a recognition that the environment of the relevant Unit would not support the introduction of such a system at that time. However, as there was no formal conclusion to the design meetings, exactly why the process stalled is unclear.

This chapter has reviewed the process undertaken by Business Unit A and provided some explanations for variances between the literature and results. These findings fill an gap in the literature regarding pay for performance and New Zealand organisations, yet some issues remain uncovered. The following chapter presents limitations of this research and recommends opportunities for further research in this field.

Chapter 6

Limitations and Future Research

1. INTRODUCTION

This research has identified a number of limitations of, and opportunities for future research. These are presented in this chapter. The limitations focus on the problem of human bias when performing case studies and problems specific to this research. Following the limitations are suggestions for future research. These opportunities have been prompted by the gaps in the current literature and the findings gained from Business Unit A.

2. LIMITATIONS

As noted in Chapter 4, there are a number of potential limitations to using the case study method. The principle limitation of this case study was the potential for human bias. The human instrument is as susceptible to mistakes as are other instruments (Merriam, 1998):

“Because the primary instrument in qualitative research is human, all observations and analyses are filtered through that human being’s worldview, values and perspective” (Merriam, 1998, p. 22).

This affects both the researcher and the respondent in various ways and illustrates the “complexities and limitations of the human mind” (McKinnon, 1988, p. 37).

The presence of an interviewer may cause respondents to alter their natural responses to a situation or question. These are known as interviewer or observer-caused effects (Breakwell, 1995; McKinnon, 1988). They are often prompted by a characteristic or attribute of the researcher, for example, accent, dress, gender, age etc. (Breakwell, 1995). To mitigate these effects each interview was conducted by the same interviewer, and the researcher was careful to dress in a manner similar to that of the respondents. Birnberg et al. (1990) use two classifications when describing

interviewer effects: demand effects and evaluation apprehension.

- i) **Demand effects:** An interviewee acts in a manner they believe the researcher desires.
- ii) **Evaluation apprehension:** An interviewee modifies their behaviour in order to impress the researcher with their knowledge, personality or other personal characteristics. In this situation, the respondent modifies their behaviour for the researcher and all others (McKinnon, 1988).

In each situation the respondent may not be truthful and this will cause errors and omissions in the research (Birnberg et al., 1990; Breakwell, 1995). In addition, respondents may suffer from “memory decay”, which will diminish the accuracy of the results (Brenner, 1985, p. 4; Breakwell, 1995). In this research there was only one reference by a respondent to any difficulty in recalling past events. Comments regarding the process Business Unit A followed were able to be verified through use of the Remuneration team minutes.

Human biases also affect the researcher and their perceptions, and cause “observer bias” (McKinnon, 1988, p. 37). “[T]he distorted effects of the researcher’s selective perception and interpretation” may bias the research findings and conclusions (McKinnon, 1988, p. 37). A researcher may prejudice their findings by placing too great an emphasis on what they ‘expect’ to happen, rather than what actually happened (Birnberg et al., 1990).

“The researcher thus brings a construction of reality to the research situation, which interacts with other people’s constructions or interpretations of the phenomenon being studied. The final product of this type of study is yet another interpretation by the researcher of others’ views filtered through his or her own” (Merriam, 1998, pp. 22-23).

The effects of human bias can be managed but not eliminated (McKinnon, 1988). This is a strong limitation of case studies and must be considered when contemplating the results.

A second limitation of this research was the proximity of the researcher to one of the interviewees. This limitation must be acknowledged, however, the comments from this respondent did not seem biased by this relationship and appeared to be more candid and open.

Data access limitations also pose a problem in case study research. A researcher is at the case study site for a limited period of time and cannot observe prior events and practices (McKinnon, 1988). A researcher is, therefore, limited with regard to the historical background they are able to obtain (McKinnon, 1988). The CCC was very cooperative and furnished the researcher with many documents that were relevant to the research, including historical information. Furthermore, there were no restrictions placed on the researcher and the areas that were available to be investigated. In line with the CCC's culture, individuals were able to decide whether or not to participate in this research. Without exception, the respondents were willing and helpful when providing information, both during and, where necessary, after the interview.

These limitations must be contemplated when reflecting on the results and conclusions advanced by this research. However, these limitations should not discourage researchers from undertaking further research in this area.

3. FUTURE RESEARCH

This research has provided an in-depth description of one Business Unit's approach to designing their pay for performance system. A number of opportunities for future research exist in this area and the related field of performance management.

A longitudinal study extending the current research into Business Unit A's remuneration system, would contribute the body of knowledge in this area. The entire development and implementation process should be reviewed. This would provide detailed information regarding development of goals and measures, a difficult area for all organisations. Investigation into the practices of another Business Unit within the CCC, would offer the opportunity to make comparisons between two Units.

The leadership and management roles within Business Unit A's process of design were filled by different people. Research is needed to determine whether the separation of these roles will be as effective as one person taking a dual role. Investigation is necessary to clarify how this affects the development and implementation process of a pay for performance plan.

Business Unit A did not refer to aligning their cost structure and remuneration system when specifying their objectives for developing a pay for performance system. Further research into this area would clarify why this may be, and whether this is also found in other public sector organisations.

Application of pay for performance was to occur throughout Business Unit A. Examination of a pay for performance system that was to only apply to a portion of an organisation would provide an interesting comparison.

This research has not addressed whether the pay for performance system will work as intended and meet the goals of Business Unit A. Research investigating the effectiveness of a pay for performance system would give some insight into the effectiveness of the design and implementation process.

Pay for performance systems within New Zealand organisations have not been widely examined. There is a dearth of case study research in this area. No obvious discrepancies were found between the predominantly overseas literature and the findings. However, it is possible that New Zealand may face difficulties peculiar to their economy. Additional research providing detailed descriptions and explanations of New Zealand practices within public and private sector organisations is therefore recommended.

Public sector and private sector service organisations, face unique difficulties when developing and implementing their systems. Further research in this area would be of interest to those considering implementation or revision of their systems.

Investigation into the development of corporate practices and guidelines within an organisation is suggested. This is particularly appropriate with many organisations delegating remuneration decisions to individual Business Units.

Examination of these issues would further expand the base of knowledge surrounding pay for performance in New Zealand organisations.

4. SUMMARY

A major criticism of the case study method is that of human bias (McKinnon, 1988). These factors cannot be eliminated, but must be controlled to ensure the validity of

the research (McKinnon, 1988). Further limitations of this research include the proximity of the researcher to an interviewee and data access limitations.

It was suggested that future research extend the pay for performance literature for public and private sector organisations within New Zealand. Longitudinal research would provide in-depth information that would be of help to managers developing and implementing new or revised remuneration systems.

Chapter 7

Conclusion

This thesis has examined the development of a pay for performance system within a New Zealand public sector organisation. While Business Unit A did not complete the design and implementation of their pay for performance system within the time-frame of this research, the body of knowledge in this area has been extended. Management accountants have been advised to broaden their research topics to examine issues included within this research.

A large component of the literature, sourced predominantly from overseas journals, originated from consultants working in the field of human resources, and managers of companies who have examined and changed their compensation systems. The culture of a country must be considered when developing a compensation system. However, there has been a dearth of research on the topic of pay for performance in a New Zealand context. Furthermore, there has been little empirical work investigating the extension of pay for performance systems to include an organisation's whole work-force, and the delegation of remuneration issues to Business Units. The research therefore sought to investigate a pay for performance system within a New Zealand organisation.

Each Business Unit within the CCC was able to address and modify their own compensation systems. This aspect of design and implementation has not been addressed in a New Zealand context and further adds to the body of knowledge surrounding pay for performance.

These points were investigated using the case study method. Fifteen interviews with eight people were conducted during each phase of research. Where possible interview data was verified through examination of documents provided by the CCC. However, the possibility of human bias remains and must be considered when contemplating the results.

The major obstacles to the design of Business Unit A's pay for performance system were problems with the Personal Value Plan and the integration of the existing collective contracts into a new system. The issues with the Personal Value Plan were being addressed, however there was no mention of any changes to the contracts within the CCC.

The design process undertaken by Business Unit A stalled at the end of 1997. This was not a conscious decision made by members of the remuneration team, rather the process stalled when a meeting was postponed and never rescheduled. The Business Unit was also facing an uncertain environment which may have contributed to the process stalling. Deciding not to design and implement a system for a Unit or organisation does not automatically mean that process has failed. It may be a recognition that the environment of the Unit would not support the introduction of such a system at that time.

Further study examining the design and implementation of pay for performance plans in New Zealand organisations would contribute greatly to the existing body of literature. Public sector and service organisation would particularly benefit from detailed research in this area. The information these investigations would generate would guide organisations in the optimal design of pay for performance systems.

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